

1 DAVID B. FARKAS (SBN 257137)
david.farkas@us.dlapiper.com
2 DLA PIPER LLP (US)
2000 Avenue of the Stars
3 Suite 400 North Tower
4 Los Angeles, California 90067-4704
Tel: (310) 595-3000
5 Fax: (310) 595-3300

6 JOHN K. LYONS (*Pro Hac Vice*)
john.lyons@us.dlapiper.com
7 JEFFREY S. TOROSIAN (*Pro Hac Vice*)
jeffrey.torosian@us.dlapiper.com
8 JOSEPH A. ROSELIUS (*Pro Hac Vice*)
joseph.roselius@dlapiper.com
9 DLA PIPER LLP (US)
10 444 West Lake Street, Suite 900
Chicago, Illinois 60606-0089
11 Tel: (312) 368-4000
12 Fax: (312) 236-7516

Attorneys for Jonathan D. King as Chapter 7 Trustee

13 **UNITED STATES BANKRUPTCY COURT**
14 **CENTRAL DISTRICT OF CALIFORNIA**
15 **LOS ANGELES DIVISION**

16 In re:
17 ZETTA JET USA, INC., a California
corporation,
18 Debtor.

19 In re:
20 ZETTA JET PTE, LTD., a Singaporean
corporation,
21 Debtor.

22 JONATHAN D. KING, solely in his capacity as
Chapter 7 Trustee of Zetta Jet USA, Inc. and
Zetta Jet PTE, Ltd.

23 Plaintiff,

24 v.

25 CAVIC AVIATION LEASING (IRELAND)
26 22 CO. DESIGNATED ACTIVITY
CORPORATION,
27 Defendants.

Lead Case No.: 2:17-bk-21386-SK

Chapter 7

Jointly Administered With:
Case No.: 2:17-bk-21387-SK
Adv. Proc. No. 2:19-ap-01147-SK

**TRUSTEE'S OPPOSITION TO CAVIC
AVIATION LEASING (IRELAND) 22 CO.
DESIGNATED ACTIVITY COMPANY'S
MOTION TO DISMISS COUNTS I, III,
IV, V, AND VI OF TRUSTEE'S FIRST
AMENDED ADVERSARY COMPLAINT**

Hearing:

Date: March 2, 2022

Time: 9:00 a.m. PST

Place: Courtroom 1575
255 East Temple Street
Los Angeles, CA 90012

TABLE OF CONTENTS

INTRODUCTION 1

BACKGROUND 3

I. Overview of the Two-Step Plane 5 Financing Transaction: The November
 17 Term Sheet 3

II. Step 1 of the Plane 5 Financing Transaction: The PDP Loan Transaction (Chart 1)...4

III. Step 2 of the Plane 5 Financing Transaction: The Plane 5 Finance Lease (Chart 2) .10

IV. The PDP Refund is Due and Payable 12

V. Bombardier Consistently Treat the APA As an Executory Contract with Debtor
 Zetta Jet PTE, not CAVIC; CAVIC Does Not Oppose This Position 12

VI. CAVIC Files Proofs of “Secured” Claims Seeking to Collect Interest from the
 Debtors on the PDP Loan 13

VII. Other Evidence that the Parties Consistently Treated the PDP Loan as
 Financing Provided to the Debtors 13

PROCEDURAL HISTORY 13

LEGAL STANDARD 14

ARGUMENT 14

I. The FAC states a claim for recovery of the PDP Refund (Counts II-VI). 14

A. The legal standard for examining the true nature of the
 underlying transactions. 15

B. The Court must review the totality of the circumstances, avoid
 reliance on conclusory labels, and consider parol evidence..... 16

C. The FAC meets the transfer-of-risk test the Ninth Circuit uses
 to determine the true nature of a transaction. 19

D. The FAC also meets eight-factor test used by the Court
 in the Dismissal Order..... 23

1. Plain Language of the Documents 23

2. The Timing of the Assignment and Loan 25

3. Whether Payments Received Under the Assignment Would be
 Applied to Reduce the Amount of the Loan 26

4. Whether the Assignment Will be a Source of Payment if the Loan
 is Not Paid..... 26

5. Whether Any Excess Paid on the Loan Will Be Returned to the Assignor...26

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6. Whether the Assignee Retains a Right to Deficiency if the
Assignment Does Not Satisfy the Amount of Debt Owed27

7. Whether the Assignee’s Rights in the Assigned Property Would
be Extinguished if the Assignor Paid the Debt from Another Source27

8. Whether Before the Complaint Was Filed, the Assignee
Filed Proofs of Claims or Other Documents Asserting That
It Was a Secured Party.....28

II. The choice-of-law provisions in the Plane 2-4 Finance Leases do not
affect the Trustee’s recharacterization claims (Count I).....29

A. California law governs the Plane 2-4 Finance Leases and requires
recharacterization.29

B. Application of Restatement Section 187(2) would not change
the conclusion that California law applies.32

C. Even if English law applied, the Plane 2-4 Finances Leases are still
finance leases, not operative leases, and English courts would
treat them as such.33

III. The Court should grant leave to replead if the FAC is dismissed in
whole or in part.....34

CONCLUSION34

TABLE OF AUTHORITIES

Page(s)

Cases

Arthur Pew Const. Co. v. Lipscomb,
965 F.2d 1559 (11th Cir. 1992)..... 17

In re Bennett Funding Grp., Inc.,
220 B.R. 743 (Bankr. N.D.N.Y. 1997)..... 17

Bly–Magee v. California,
236 F.3d 1014 (9th Cir. 2001)..... 34

In re Candy Lane Corp.,
38 B.R. 571 (Bankr. S.D.N.Y. 1984) 16, 25

Carlson v. Tandy Comput. Leasing,
803 F.2d 391 (8th Cir. 1986)..... 30

In re Com. Money Ctr., Inc.,
350 B.R. 465 (B.A.P. 9th Cir. 2006)..... 19, 20, 21, 30

Disability Rts. Mont., Inc. v. Batista,
930 F.3d 1090 (9th Cir. 2019)..... 14

In re Eagle Enters., Inc.,
223 B.R. 290 (Bankr. E.D. Pa. 1998)..... 30, 32

Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.,
67 F.3d 1063 (2d Cir. 1995)..... 19, 20, 22

In re Evergreen Valley Resort, Inc.,
23 B.R. 659 (Bankr. D. Me. 1982) 16

Fireman’s Fund Ins. Co. v. Grover (In re Woodson Co.),
813 F.2d 266 (9th Cir. 1987)..... 16, 21

In re Gibson,
234 B.R. 776 (Bankr. N.D. Cal. 1999)..... 30

In re Joseph Kanner Hat Co.,
482 F.2d 937 (2d Cir. 1973) 16, 17, 18, 25

King v. Yuntian,
Case No. 2:19-ap-01383-SK, Dkt. 175 18

Knevelbaard Dairies v. Kraft Foods, Inc.,
232 F.3d 979 (9th Cir. 2000)..... 34

1 *Lopez v. Smith*,
2 203 F.3d 1122 (9th Cir. 2000) (en banc) 34

3 *Major’s Furn. Mart v. Castle Credit Corp.*,
4 602 F.2d 538 (3d Cir. 1979) 17, 21, 29

5 *Marsh v. McNair*,
6 99 N.Y. 174 (N.Y. 1885) 17

7 *Nayab v. Capital One Bank (U.S.)*,
8 942 F.3d 480 (9th Cir. 2019) 14, 18, 22

9 *Nickey Gregory Co. v. Agricap*,
10 597 F.3d 591 (4th Cir. 2010) 21

11 *Paloian v. Lasalle Bank*,
12 463 B.R. 93 (Bankr N.D. Ill. 2011) 27

13 *S&H Packing & Sales Co. v. Tanimura Distrib., Inc.*,
14 883 F.3d 797 (9th Cir. 2018) (en banc) *passim*

15 *Seeman v. Philadelphia Warehouse Co.*,
16 274 U.S. 403, 47 S. Ct. 626, 71 L. Ed. 1123 (1927) 31

17 *In re Shoot the Moon, LLC*,
18 2020 WL 6588407 (Bankr. D. Mont. Nov. 6, 2020) 20

19 *This Is Me, Inc. v. Taylor*,
20 157 F.3d 139 (2d Cir. 1998) 18

21 *Turner v. Aldens, Inc.*,
22 433 A.2d 439 (N.J. Sup. Ct. 1981) 30

23 *U.S. & State v. My Left Foot Children’s Therapy, LLC*,
24 871 F.3d 791 (9th Cir. 2017) 23

25 *U.S. v. Lester*,
26 235 F. Supp. 115 (S.D.N.Y. 1964) 17

27 *United Airlines, Inc. v. HSBC Bank USA, N.A.*,
28 416 F.3d 609 (7th Cir. 2005) 33

In re Zukerkorn,
484 B.R. 182 (B.A.P. 9th Cir. 2012) 32, 33

Statutes

11 U.S.C. § 365 33

11 U.S.C. § 542 1, 14

1 11 U.S.C. § 544 1, 14
2 California UCC § 1301..... 2, 30, 31
3 UCC § 1-301 31
4 UCC Series § 1-301:1..... 31
5 UCC Article 9..... 12, 13, 30
6 **Other Authorities**
7 58 N.Y. Jur. 2d, Evid. & Witnesses § 602 18
8 Restatement (Second) of Conflicts of Laws..... 2, 29
9 Fed. R. Civ. P. 9(b)..... 34
10
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1 **INTRODUCTION¹**

2 The Trustee’s central claims against CAVIC — for the recovery of a \$30 million refund to
3 satisfy a pre-delivery payment (the “PDP”) paid to Bombardier to manufacture Plane 5 under an
4 aircraft purchase (the “Plane 5 APA”) — turn on whether an assignment of a contract (the “March
5 31 Assignment”) is a security assignment or an absolute assignment. If the March 31 Assignment
6 is a security assignment, the Trustee is entitled to the refund. If the March 31 Assignment is an
7 absolute assignment, CAVIC gets the refund. It is that straightforward, as this Court recognized in
8 its October 15, 2020 order (the “Dismissal Order”).

9 When all of the transaction documents are viewed together, along with other factual
10 allegations that the Court must assume to be true (including parol evidence), the First Amended
11 Complaint (the “FAC”) alleges that the March 31 Assignment is a security assignment. Stripping
12 away the superficial complexity of the aircraft financing structure, the underlying substance is
13 simple: a secured financing transaction, much like a loan and mortgage. CAVIC lent the Debtors
14 \$30 million (the “PDP Loan”) under a loan agreement called a forward purchase agreement (the
15 “Plane 5 FPA”). CAVIC paid that \$30 million to Bombardier on behalf of the Debtors to fund the
16 PDP under the Plane 5 APA. As security for the \$30 million loan, much like a mortgage, the
17 Debtors and CAVIC entered into the March 31 Assignment, which assigned the Debtors’ right to
18 the Refund to CAVIC. However, CAVIC failed to perfect the March 31 Assignment, and the \$30
19 million Refund on account of the PDP is subject to avoidance and recovery by the Trustee under
20 Sections 544 (Count IV) and 550 (Count V) against CAVIC and Section 542 (Count VI) against
21 Bombardier. Apart from its inclusion in a complicated aircraft financing structure, the Plane 5
22 FPA/March 31 Assignment is no different than any other secured loan: once you pay off your debt
23 (the PDP Loan), you get your asset (the assigned contract rights) back free and clear of the lender’s
24 interest.

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26 _____
27 ¹ The Trustee incorporates by reference his *Opposition to Bombardier Aerospace Corporation’s Motion to Dismiss*
28 *Counts II and IV of Trustee’s First Amended Adversary Complaint* (the “BAC Opposition”). Terms not defined herein
or in the BAC Opposition shall have the meaning given in the FAC.

1 In its Motion to Dismiss, CAVIC relies heavily on this Court’s Dismissal Order to
2 challenge the FAC. But the FAC adds specific factual allegations and clarifies that the Plane 5
3 FPA is a loan agreement for the PDP Loan and the March 31 Assignment is security for the
4 Debtors’ repayment of that loan. These allegations include detailed descriptions of interdependent
5 transactional documents and overwhelming parol evidence (including the Term Sheet) that is
6 admissible under well-settled New York law. These allegations show that the Debtors were
7 obligated on a full recourse basis to repay the “PDP Loan” and that the March 31 Assignment was
8 a “security” for repayment of the loan.

9 In addition, the allegations in the FAC meet the “transfer of risk” test recently adopted by
10 the en banc Ninth Circuit in *S&H Packing & Sales Co. v. Tanimura Distrib., Inc.*, 883 F.3d 797
11 (9th Cir. 2018) (en banc). The March 31 Assignment did not transfer risk from the Debtors to
12 CAVIC because CAVIC could force the Debtors to repay the PDP Loan if other risks materialized
13 (aside from the primary credit risk of the Debtors), including if Bombardier failed to deliver Plane
14 5 and then also failed to return the PDP. Thus, the Debtors never transferred any risk of a
15 Bombardier default or other risks because they were always on the hook to repay the PDP Loan to
16 CAVIC. The FAC similarly meets an overlapping alternative eight-factor test that courts have
17 employed consistent with the “transfer of risk” test.

18 CAVIC also challenges Count I of the FAC, which seeks to recharacterize three leases for
19 aircraft that were delivered (the Plane 2-4 Financed Leases). Contrary to CAVIC’s assertions, the
20 FAC states a plausible claim for recharacterization. In particular, the Leases are *per se* security
21 interests under the “economic realities” test under federal bankruptcy law and the California
22 Uniform Commercial Code because (i) they cannot be terminated by the Debtors, (ii) rent is
23 measured by principal and interest, and (iii) [REDACTED]

24 [REDACTED] The parties’
25 contractual choice of law, the law of England, is disregarded because Section 1301 of the
26 California UCC — the statutory directive under 6(1) of the Restatement (Second) of Conflicts of
27 Laws — does not consider the parties’ contractual choice of law because England had no
28

1 reasonable relationship to the transaction. Alternatively, even under English law, courts will
2 disregard the label attached by the parties and look at the legal substance. That legal substance
3 treats the Plane 2-4 Financed Leases as financing arrangements under the laws of England with
4 the risks and rewards of ownership vesting with the Debtors.²

5 **BACKGROUND**

6 **I. Overview of the Two-Step Plane 5 Financing Transaction: The November 17 Term
Sheet**

7 On December 10, 2015, [REDACTED]

8 [REDACTED]³⁴ Plane 5 was the
9 fourth Bombardier plane financed by CAVIC, following Planes 2, 3, and 4. [REDACTED]

10 [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 **The Term Sheet.** In the fall of 2016, CAVIC and Zetta PTE began negotiating the terms
14 of two-step financing transaction (the “Plane 5 Financing Transaction”) to finance the Debtors’
15 acquisition of Plane 5. The negotiations culminated into a letter of intent (the “Term Sheet”) signed
16 on November 17, 2016 by Zetta PTE and AVIC (parent of CAVIC) that outlined the structure of
17 the Plane 5 Financing Transaction. [FAC ¶¶ 46; Composite Ex. 1 (Term Sheet), App’x at A90].

18 **The PDP Loan:** [REDACTED]

- 19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 • [REDACTED]
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25 _____
26 ² The Trustee also preserves all arguments and claims based upon the proposed amendments to Count I of the FAC
that the Court previously denied.

27 ³ The parties also executed a series of amendments to the Plane 5 APA over time. Unless otherwise specified, the term
“Plane 5 APA” refers to the contract as amended.

28 ⁴ Any references or citations to App’x refer to appendices to the Lyons Dec. filed contemporaneously therewith.

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- [Redacted]

The Plane 5 Finance Lease: [Redacted]

[Redacted]

II. Step 1 of the Plane 5 Financing Transaction: The PDP Loan Transaction (Chart 1).

[Redacted]

⁵ A chart attached hereto as Exhibit 1 outlines the PDP Loan Transaction.

⁶ [Redacted]

⁷ [Redacted]

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[REDACTED]

¹¹ [See *infra* at 7-8].

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[REDACTED]

¹² Of course, to do so, the Debtors would be required to [REDACTED]

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[Redacted text block covering lines 1 through 25]

¹² The other Transaction Documents support this, [Redacted]

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[REDACTED]

The Consent. As additional security, on March 31, 2017, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] “Buyer” is defined in the
Plane 5 APA and refers to Zetta Jet PTE. [Sch. 2, Ex. 2-53 (Plane 5 APA) at 1, App’x at A1]. Zetta
Jet PTE was consistently regarded as the “Buyer” when such term was used in the Transaction
Documents.¹⁴ [REDACTED]

[REDACTED]

¹⁴ CAVIC is just flat wrong that when it states that it was the “Buyer.” Although CAVIC had the rights and obligations
of the Buyer assigned to it under the March 31 Assignment, it was not the Buyer itself. [See [REDACTED]
[REDACTED].

1 [REDACTED]

2 **Interdependency of the Transaction Documents:** The PDP Facility Agreement defined
3 “Transaction Documents” to include, among others, the Plane 5 APA, the Plane 5 FPA, the Plane
4 5 FPA Guarantee, the March 31 Assignment, the EDC-CAVIC Security Agreement, and the
5 Consent. [Sch. 2, Ex. 2-58 (PDP Facility Agreement) at 114 (definition of “Transaction
6 Documents”), App’x at A24]. The Plane 5 FPA also attached and incorporated the Plane 5 Lease
7 and Plane 5 Sublease as Transaction Documents into the Plane 5 FPA. [Sch. 2, Ex. 2-63 (Plane 5
8 FPA), § 15.2 (incorporating the Plane 5 Lease into integration clause), App’x at A77 and Schedule
9 1, Conditions Precedent §1(f) (defining the Sublease and Lease Guarantees as “Transaction
10 Documents,” the delivery of which are conditions precedent to the Seller’s obligations under the
11 Plane 5 FPA) (collectively, the “Plane 5 Financing Transaction Documents”)].¹⁵

12 All of the Plane 5 Financing Transaction Documents were (i) signed prior to or at closing;
13 (ii) delivered at closing; and (iii) were conditions precedent to the parties’ obligations under the
14 Plane 5 Financing Transaction Documents. [Sch. 2, Ex. 2-58 (PDP Facility Agreement), § 4.1 &
15 Schedule 2 (Conditions Precedent), App’x at A6]. [REDACTED]

16 [REDACTED]
17 [REDACTED]
18 [REDACTED]
19 [REDACTED]
20 [REDACTED]

21 **III. Step 2 of the Plane 5 Financing Transaction: The Plane 5 Finance Lease (Chart 2)**

22 [REDACTED]
23 [REDACTED]
24 [REDACTED]

25 _____
26 ¹⁵ Both of the Transaction Documents defined under the PDP Facility Agreement and the Plane 5 FPA shall be defined
together as the “Plane 5 Financing Transaction Documents.”

27 ¹⁶ A chart attached hereto as Exhibit 2 outlines the Plane 5 Financing Transaction.
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1 [REDACTED] Put
2 otherwise, CAVIC never had any rights to any residual value in Plane 5 following completion of
3 the payments and Zetta Jet PTE was always intended by the parties to ultimately own Plane 5
4 notwithstanding CAVIC's formal retention of legal title during the repayment term. However, the
5 second step never occurred because the Debtors filed for bankruptcy before Plane 5 was delivered.

6 **IV. The PDP Refund is Due and Payable**

7 [REDACTED]
8 [REDACTED]
9 [REDACTED] As further stated in the BAC Response, BAC is
10 required to pay the Trustee the \$30 million on account of the PDP if the Court determines that the
11 March 31 Assignment is a security assignment. [BAC Opposition at 5-10].

12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 CAVIC, however, did not perfect this security interest in the rights assigned under the Plane 5
16 APA, including the right to the refund, by filing a financing statement pursuant to Article 9 of the
17 Uniform Commercial Code (the "UCC") or other applicable perfection regime. [FAC ¶ 93].

18 **V. Bombardier Consistently Treat the APA As an Executory Contract with Debtor Zetta
Jet PTE, not CAVIC; CAVIC Does Not Oppose This Position**

19 On September 15, 2017, the Debtors filed for chapter 11 before Plane 5 could be delivered.
20 As more fully stated in the BAC Response, BAC treated the Plane 5 APA as an executory contract
21 with debtor Zetta Jet PTE in the chapter 11 cases in the BAC Pleadings filed with the Court. [BAC
22 Opposition at 8-9; *see also* FAC ¶¶ 55, 63]. Moreover, even though CAVIC was an active
23 participant in the bankruptcy cases, at no point during the Debtors' bankruptcy proceedings did
24 CAVIC ever file a pleading in response to the BAC Pleadings asserting the Plane 5 APA was no
25 longer an executory contract of the Debtors or that the Debtors no longer had any rights under the
26 Plane 5 APA by reason of the March 31 Assignment. Instead, it sat back and waited to see how
27 things played out.

1 **VI. CAVIC Files Proofs of “Secured” Claims Seeking to Collect Interest from the Debtors**
2 **on the PDP Loan**

3 On April 24, 2018, CAVIC filed proof of claim 162 (“POC 162”) and 165 (“POC 165”) in
4 Zetta PTE’s Chapter 7 Case and proof of claim 163 (“POC 163”) and 166 (“POC 166”) in Zetta
5 USA’s Chapter 7 Case (collectively, the “CAVIC POCs”). The CAVIC POCs relate to the Plane
6 5 APA and March 31 Assignment and indicate that all or part of the claim is secured. [FAC ¶ 65;
7 Composite Ex. 5]. The CAVIC POCs asserted a claim for \$1,416,591.34 against the Debtors for
8 breach of the Plane 5 FPA Guarantee and the Plane 5 FPA for unpaid interest and costs under the
9 Plane 5 FPA. [REDACTED]

10 [REDACTED] More importantly, the fact that CAVIC filed proofs of claim
11 to collect “interest” from the Debtors on \$30 million PDP advance shows that the \$30 million was
12 a loan to the Debtors and that the March 31 Assignment was for the purpose of securing the
13 repayment of this loan. [Composite Ex. 5, POC 162, at 9, ¶ 14; POC 163 at 9, ¶ 14; App’x at A93
14 - A94]. CAVIC further noted that its claim for interest was “secured.” *Id.*

15 **VII. Other Evidence that the Parties Consistently Treated the PDP Loan as Financing**
16 **Provided to the Debtors**

17 [REDACTED]

18 In the bankruptcy cases, Bombardier took the position that the Plane 5 APA was an
19 executory contract with Debtor Zetta PTE as the counterparty, showing that CAVIC, per the course
20 of conduct of the parties, was not the true counterparty to the Plane 5 APA after the alleged
21 “absolute” assignment. [BAC Opposition at 8-9].

22 **PROCEDURAL HISTORY**

23 On May 21, 2019, the Trustee filed his complaint commencing this action. In January 2020,
24 CAVIC and Bombardier filed motions to dismiss. On October 7, 2020, the Court entered the
25 Dismissal Order.

26 On July 28, 2021, the Trustee filed the FAC. [Dkt. 301]. In Count I of the FAC, the Trustee
27 seeks to recharacterize the Plane 2, Plane 3, and Plane 4 Financed Leases. In Count III through VI
28

1 of the FAC, the Trustee seeks a declaration that the March 31 Assignment is unperfected (Count
2 III), that the unperfected March 31 Assignment is subject to avoidance under Section 544 of the
3 Bankruptcy Code (Count IV), that the avoidance of the March 31 Assignment entitles the Trustee
4 to recover the PDP (Count V), and that BAC, currently holding the PDP, is required to turn over
5 the PDP to the Trustee under Section 542 of the Bankruptcy Code (Count VI).

6 **LEGAL STANDARD**

7 “To survive a motion to dismiss, a complaint must contain sufficient factual matter,
8 accepted as true, to state a claim to relief that is plausible on its face.” *Nayab v. Capital One Bank*
9 (*U.S.*), 942 F.3d 480, 496 (9th Cir. 2019). “A claim has facial plausibility when the plaintiff pleads
10 factual content that allows the court to draw the reasonable inference that the defendant is liable
11 for the misconduct alleged.” *Id.* The Court shall “accept as true all factual allegations in the
12 operative complaint” and “construe them in the light most favorable to Plaintiff as the non-moving
13 party.” *Id.* Competing inferences are drawn in plaintiff’s favor. *Disability Rts. Mont., Inc. v.*
14 *Batista*, 930 F.3d 1090, 1096–97 (9th Cir. 2019). A complaint should only be dismissed where “a
15 cognizable legal theory is absent or if the facts alleged fail to suffice under a cognizable claim.”
16 *Nayab*, 942 F.3d at 496.

17 To be sufficient, factual allegations must be more than “bare conclusions.” *Id.* at 497. But
18 “the pleader is not required to allege facts that are peculiarly within the opposing party’s
19 knowledge, and allegations based on information and belief may suffice so long as the allegations
20 are accompanied by a statement of facts upon which the belief is founded.” *Id.* at 493 (cleaned up).

21 **ARGUMENT**

22 **I. The FAC states a claim for recovery of the PDP Refund (Counts II-VI).**

23 The Court concluded in its Dismissal Order that Counts III-VI of the Original Complaint
24 are intertwined and the trustee’s right to avoid and recover the \$30 million refund under these
25 counts depends entirely upon whether the March 31 Assignment was an absolute assignment or an
26 assignment for security. If the March 31 Assignment is a security assignment, then the Trustee is
27 entitled to the \$30 million PDP because it is property of the estate. If the March 31 Assignment is
28

1 an absolute assignment, then CAVIC is entitled to the \$30 million PDP since it would not be
2 avoidable. Counts III-VI of the FAC similarly turn on this issue. Because debtor Zetta PTE granted
3 the March 31 Assignment to secure the Debtors' full recourse obligations to CAVIC to repay the
4 PDP Loan under the first step of the Plan 5 PDP Financing Transaction, the March 31 Assignment
5 is a security assignment under either the transfer-of-risk test or the eight-factor test.

6 **A. The legal standard for examining the true nature of the underlying**
7 **transactions.**

8 In determining whether an assignment is absolute or for security, the Court must examine
9 the true nature of the underlying transaction. In doing so, the Court must consider the totality of
10 the circumstances in reviewing the underlying transaction documents while avoiding reliance on
11 labels that are inconsistent with the true nature of the transactions. Moreover, under applicable
12 New York, it is well settled that parol evidence must be considered in determining whether an
13 assignment is not absolute but for security.

14 The Plane 5 Financing Transaction Documents, [REDACTED]

15 [REDACTED] show that March 31 Assignment was a security assignment. [REDACTED]
16 [REDACTED]
17 [REDACTED]
18 [REDACTED]

19 [REDACTED] Simply put, the true nature of the transaction was a loan and a
20 security assignment to secure the loan.

21 However, if the Court needs to probe deeper into whether the March 31 Assignment
22 constituted a security assignment or absolute assignment, two related tests have been used by
23 courts to assist them in conducting this examination: the "transfer of risk" test and an eight-factor
24 test. These tests overlap and have been developed over time in various contexts. As noted below,
25 the transfer-of-risk test emphasizes whether an assignee had recourse against debtor with respect
26 to the assigned rights as the key factor, while the eight-factor test looks at this factor as well as a
27 number of additional factors identified by courts.

28 The FAC alleges facts that support a plausible claim that the March 31 Assignment is a

1 security assignment based upon the true nature of the underlying transactions. Those allegations
2 satisfy both the transfer-of-risk and eight-factor tests.

3 **B. The Court must review the totality of the circumstances, avoid reliance**
4 **on conclusory labels, and consider parol evidence.**

5 Special rules apply when a Court evaluates whether an assignment operates to transfer a
6 security interest (a “security assignment”) or an ownership interest (an “absolute assignment”).
7 The analysis concerns the “true nature of the underlying transactions,”¹⁷ under a totality of
8 circumstances rather than solely relying upon conclusory labels such as “absolute assignment” or
9 “sale” contained in contractual language. *See Fireman’s Fund Ins. Co. v. Grover (In re Woodson*
10 *Co.)*, 813 F.2d 266, 272 (9th Cir. 1987) (rejecting a plain language argument because “labels
11 cannot change the true nature of the underlying transactions”); *S&H Packing & Sales Co. v.*
12 *Tanimura Distributing, Inc.*, 883 F.3d 797, 808 (9th Cir. 2018) (explaining that the analysis must
13 “avoid reliance on labels”); *In re Candy Lane Corp.*, 38 B.R. 571, 574-75 (Bankr. S.D.N.Y. 1984)
14 (applying New York law) (“A document which is seemingly an absolute assignment on its face
15 may nevertheless be treated as a security agreement in certain instances.”); *In re Evergreen Valley*
16 *Resort, Inc.*, 23 B.R. 659, 661 (Bankr. D. Me. 1982) (holding that “the determination of whether a
17 particular assignment constitutes a sale (an absolute transfer) or a security transaction is left to the
18 courts” and that “the label attached to the transaction by the parties does not control”); *In re Joseph*
19 *Kanner Hat Co.*, 482 F.2d 937, 940 (2d Cir. 1973) (“[T]he courts will determine the true nature of
20 a security transactions, and will not be prevented from exercising their function of judicial review
21 by the form of words the parties may have chosen”).

22 For nearly a century, courts have consistently agreed that in conducting this analysis, the
23 traditional mode of inquiry (i.e., starting with the four corners of the document and then moving
24 to parol evidence only if the text is ambiguous) does not apply. “Long before the adoption of the
25 U.C.C. . . . the parol evidence rule has opened like a leaky sieve to allow other evidence of the true

26 _____
27 ¹⁷ The Court previously noted all writings which for part of a single transaction and are designed to effectuate the
28 same purpose be read together, even when they were “executed on different dates and were not between the same
parties.” [Dismissal Order at 37 (citations omitted)].

1 nature of the transaction.” *Joseph Kanner*, 482 F.2d at 940 (cleaned up); *see also Major’s Furn.*
2 *Mart v. Castle Credit Corp.*, 602 F.2d 538, 543 (3d Cir. 1979) (“Neither the form of a contract nor
3 the name given it by the parties controls its interpretation. In determining the real character of a
4 contract courts will always look to its purpose,” including by examining “the parties business
5 activities, objectives, and relationship.”); *Arthur Pew Const. Co. v. Lipscomb*, 965 F.2d 1559, 1575
6 (11th Cir. 1992) (citing 4 Corbin, *Contracts*, § 882, and recognizing “[a]n absolute assignment in
7 form can be shown to be for collection only”); *see also* 4 Corbin, *Contracts*, § 882, at 543 (1951)
8 (“It is a question of fact, and sometimes a difficult one, whether an assignment is an outright
9 purchase and sale or an assignment as collateral security only. *Parol evidence is admissible, even*
10 *as against creditors, to show that an assignment absolute in form was in fact made only as*
11 *collateral security.*”) (emphasis added).

12 Indeed, it has been a well settled rule of New York law¹⁸ that parol evidence may be used
13 to demonstrate that a transfer that was fashioned as an absolute assignment was intended for
14 security. *Marsh v. McNair*, 99 N.Y. 174, 178-179 (N.Y. 1885) (“It is well settled in the law of this
15 State, that an instrument assigning or conveying real or personal property in absolute terms may
16 by parol evidence be shown to have been intended as security only. While this rule is an exception
17 to the general rule of evidence, forbidding the contradiction or explanation of written instruments
18 by parol evidence, it has long been established in the law of this State.”); *In re Bennett Funding*
19 *Grp., Inc.*, 220 B.R. 743, 762 (Bankr. N.D.N.Y. 1997) (“Even where a transfer is fashioned as an
20 absolute assignment, extrinsic evidence may be used to demonstrate that the transaction was
21 intended for security . . . If the assignment be absolute in form, the fact that it was made as collateral
22 security may be shown by parol evidence.”) (quoting *Frensdorf v. Strumpf*, 30 N.Y.S. 2d 211, 218
23 (N.Y. Sup. Ct. 1941)); *U.S. v. Lester*, 235 F. Supp. 115, 122 (S.D.N.Y. 1964) (stating that New
24 York follows “the general rule that parol evidence may be introduced to show that a conveyance
25 absolute on its face was intended as security only”) (citing *Warren v. Chem. Bank Trust Co.*, 79

27 ¹⁸ In the Dismissal Order, the Court recognized that New York law governs the Plane 5 APA and the March 31
28 Assignment. [Dismissal Order at 37]. No party disputes this.

1 N.Y.S. 2d. 776 (N.Y. Sup. Ct. 1948)); 58 N.Y. Jur. 2d, Evid. & Witnesses § 602 (“Parol evidence
2 is admissible, even without establishing fraud in the inception of the transfer, to show that a transfer
3 in writing that is absolute in its terms was in fact given as security.”).

4 Parol evidence, most notably the Term Sheet, supports the Trustee’s argument. The Court
5 must consider this parol evidence, especially on a motion to dismiss where all allegations are
6 assumed to be true and the purpose of the analysis is whether the allegations are “plausible.”¹⁹ *See*
7 *Nayab*, 942 F.3d at 496; *Joseph Kanner*, 482 F.2d at 940 (disregarding “absolute” assignment of
8 entire claim based upon overwhelming parol evidence indicating true nature of transaction to
9 constitute security assignment).

10 Here, [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]

15 [REDACTED] In addition, other contemporaneous statements made by the
16 parties, which the Court did not address, indicated that PDP loan was part of a financing provided
17 to the Debtors. [Composite Ex. 2, at 3, App’x at A91].

18
19 ¹⁹ Apart from the consistent caselaw that directs a court to review the entirety of the transaction, including parol
20 evidence, in making a determination whether an assignment was absolute or for security, [*see supra* at 16-18], it is
21 well settled that a court must examine parol evidence to explain or discern an ambiguous contract term under New
22 York law. *This Is Me, Inc. v. Taylor*, 157 F.3d 139, 143 (2d Cir. 1998). Section 10.1, when read together with the other
23 Transaction Documents, at minimum, created an ambiguity as to the nature of the assignment that would mandate the
24 introduction of parol evidence to discern the true intent of the parties.

25 ²⁰ Contrary to CAVIC’s assertion that the Trustee cannot plead that the Term Sheet was signed on information and
26 belief, [Dkt. 312 at 17 n.28], the Trustee does not have the burden of pleading with respect to the Term Sheet because
27 it is a document that is in CAVIC’s possession and of which CAVIC has personal knowledge. [*See King v. Yuntian*,
28 Case No. 2:19-ap-01383-SK, Dkt. 175, at 45]; *Nayab*, 942 F.3d at 495. But even if the Trustee had that burden, the
Trustee has met it. Contrary to CAVIC’s allegation that there is no fact alleged to support the Trustee’s belief that the
Term Sheet was signed, [Dkt. 312 at 17 n. 28], the Trustee pled in the First Amended Complaint that the belief was
based upon e-mails exchanged between the parties, which were attached noting that the term sheet had been signed.
[Am. Compl. ¶46, Composite Ex. 1 at 1 [REDACTED]]

[REDACTED] In any event, the Trustee has found a copy of the signed Term Sheet among documents located in Singapore
and will be filing it as a replacement exhibit to the FAC. *See* Declaration of John K. Lyons in Support of the Trustee’s
Opposition to CAVIC Aviation Leasing (Ireland) 22 Co. Designated Activity Company’s Motion to Dismiss Counts
I, III, IV, V, and VI of the Trustee’s First Amended Complaint, ¶ 5, Exh. A. A copy of the signed Term Sheet is also
available at App’x at A90.

1 This makes sense because the point of having a judicial doctrine to identify disguised
2 security interests *is that they may be disguised by the text of the agreement*. Instead, a totality of
3 the circumstances analysis applies, under which the Court may consider “all facts and
4 circumstances surrounding the transactions at issue.” *In re Com. Money Ctr., Inc.*, 350 B.R. 465,
5 481 (B.A.P. 9th Cir. 2006) (quoting *In re Golden Plan of Cal., Inc.*, 829 F.2d 705, 708 (9th Cir.
6 1986)).

7 **C. The FAC meets the transfer-of-risk test the Ninth Circuit uses to**
8 **determine the true nature of a transaction.**

9 Courts have used a transfer-of-risk test from the debtor’s or assignor’s standpoint to assist
10 in answering the ultimate question concerning “true nature” of the transaction. *S&H Packing &*
11 *Sales Co., Inc. v. Tanimura Distrib., Inc.*, 883 F.3d 797, 808 (9th Cir. 2018) (holding that a court
12 “should look to the substance of the transaction” to determine whether a transfer of ownership or
13 a security interest has occurred and “[i]n doing so, the transfer of risk should be a primary factor
14 to which a court looks”); *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063, 1068
15 (2d Cir. 1995) (stating that the “root” of the analysis “is the transfer of risk”).

16 In *S&H Packing*, the en banc Ninth Circuit adopted the “transfer of risk” test for
17 determining whether a transfer of a receivable under a factoring agreement was a true sale of the
18 debtor’s contract rights or a security interest incident to a secured loan. *S&H Packing* involved a
19 priority fight between PACA claimants and factoring lenders to collections on receivables. The
20 PACA claimants argued that the collections on the accounts receivable – that they asserted was
21 never absolutely conveyed by the debtor – were subject to a statutorily imposed trust under PACA
22 that had priority over the factoring lenders’ perfected lien on the debtor’s accounts receivable.

23 After conducting an exhaustive review of caselaw in the Ninth Circuit and other circuits,
24 the Ninth Circuit adopted the “transfer of risk” test to determine whether an assignment constituted
25 a true sale/absolute assignment or a loan transaction. As noted in *S&H Packing*, the “transfer of
26 risk” test was a long-standing test by courts to look past labels and discern the true intent of parties
27 in determining whether an assignment was absolute or for security, i.e, whether a transaction was
28

1 a sale or a loan.

2 In adopting this test, *S&H Packing* relied heavily on the Second Circuit’s decision in *In re*
3 *Endico Potatoes, Inc. v. CIT Grp./Factoring, Inc.*, 67 F.3d 1063 (2nd Cir. 1995), which compiled
4 caselaw that applied the “transfer of risk” test in a various contexts, including security assignments.
5 *Id.* at 1068 (citing *Joseph Kanner*, 482 F.2d at 940 (applying Connecticut law) (disregarding
6 “absolute” assignment of entire claim based upon overwhelming parol evidence indicating true
7 nature of transaction to constitute security assignment); *Hassett v. Sprague Elec. Co.*, 30 B.R. 642,
8 647-48 (Bankr. S.D.N.Y. 1983) (holding that an assignment for security existed because payments
9 under an assigned equipment lease in excess of the loan balance were paid back to assignor);
10 *Evergreen Valley Resort*, 23 B.R. at 660-61 (applying Maine law) (factors that vitiated against an
11 absolute assignment included (i) right to collect deficiency from assignor, (ii) extinguishment of
12 assignment if loan balance repaid from other source, and (iii) assignment did not discharge
13 assignor’s debt to assignee); and *Major’s Furn. Mart*, 602 F.2d at 543-46 (applying Pennsylvania
14 law) (“sale” of accounts receivable language disregarded because there was full recourse to
15 assignor under repurchase option clause)).

16 In applying the factors, the analysis must tie to how the parties allocate risk, i.e., who is
17 bearing the true burden of ownership after the initial transaction. *See Com. Money Ctr.*, 350 B.R.
18 at 483 (considering other evidence, although ultimately ruling on the basis that the transaction
19 documents required debtor to (i) indemnify and guarantee the lender and (ii) incur all expenses in
20 connection with loan servicing); *In re Shoot the Moon, LLC*, 2020 WL 6588407, at *4 (Bankr. D.
21 Mont. Nov. 6, 2020) (“One consideration that transcends and unites the specific factors, however,
22 is the nature of how the parties allocated *risk*.”) (emphasis original).

23 The *S&H Packing* court quoted the holding from *Endico Potatoes* that explained why the
24 transfer of risk between an assignee and an assignor is the key factor in determining whether a
25 transaction was a security interest or a true sale/absolute assignment:

26 The root of all of these factors is the transfer of risk. Where the lender has purchased
27 the accounts receivable, the borrower’s debt is extinguished and the lender’s risk
28 with regard to the performance of the accounts is direct, that is, the lender and not

1 the borrower bears the risk of non-performance by the account debtor. If the lender
2 holds only a security interest, however, the lender's risk is derivative or secondary,
3 that is, the borrower remains liable for the debt and bears the risk of non-payment
by the account debtor, while the lender only bears the risk that the account debtor's
non-payment will leave the borrower unable to satisfy the loan.

4 *S&H Packing*, 833 F.3d at 797 (quoting *Endico Potatoes*).

5 Thus, the fact that CAVIC may not be able to collect *from the Debtors* because *the Debtors*
6 later became insolvent is irrelevant to the transfer-of-risk test. Rather, the relevant inquiry is
7 whether the March 31 Assignment transferred the risk of *BAC's* insolvency *from the Debtors to*
8 *CAVIC*. As the Ninth Circuit BAP stated in *Commercial Money Center*, the allocation of risk *at*
9 *the time of contracting* is the relevant inquiry:

10 In determining whether parties intended a sale or a loan the issue is how risks are
11 contractually allocated when the transactions are entered into. The fact that Debtor
12 later became insolvent is irrelevant. In *Woodson*²¹ the debtor had not paid its
13 investors and was in bankruptcy but the contractual risk was allocated to the
debtor. Primarily for that reason the transaction was determined to be a loan rather
than a sale.

14 350 B.R. at 484.

15 That risk was never transferred from the Debtors to CAVIC because CAVIC had the ability
16 to force the Debtors to repay the PDP Loan. It does not matter that CAVIC never actually issued
17 a Notice to Purchase. Courts have uniformly found that a repurchase clause that *could* require a
18 borrower to repurchase accounts receivable from a lender constitutes the type of recourse
19 obligation that negates an absolute assignment. *See Major's Furn. Mart*, 602 F.2d at 545-46
20 (holding that the Debtor's obligation to repurchase any defaulted accounts was a form of recourse
21 that rendered the assignment as one for security); *Nickey Gregory Co. v. Agricap*, 597 F.3d 591,
22 602 (4th Cir. 2010) (holding that a repurchase obligation prevented the transfer of risk and
23 therefore rendered the agreement a loan, not an absolute assignment, at the time of the assignment);
24 *S&H Packing*, 883 F.3d at 809 (holding that a buyer's right to force the seller to repurchase non-

25
26
27
28

²¹ *Fireman's Fund Ins. Co. v. Grover (In re Woodson Co.)*, 813 F.2d 266 (9th Cir. 1987).

1 performing accounts meant that the seller still “bears the risk of non-payment” after the
2 assignment) (quoting *Endico Potatoes*).

3 Here, there were multiple risks under the Plane 5 APA at the time of the March 31
4 Assignment. The most obvious risk was that [REDACTED]

5 [REDACTED]
6 [REDACTED] This risk was hardly speculative.
7 Bombardier was on the verge of bankruptcy in 2016 and presented a real risk of insolvency
8 jeopardizing collection of a PDP refund. Indeed, the Consent itself expressly addressed EDC’s
9 remedies if *Bombardier* defaults.²²

10 The March 31 Assignment did nothing to transfer these risks away from the Debtors. [REDACTED]

11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]
18 [REDACTED] *ee Endico Potatoes* at 1069 (assignee could demand payment directly from assignor
19 at any time for the entire outstanding loan balance notwithstanding that CIT held what it termed
20 an assignment of assignor’s accounts indicated, among other factors, that the primary risk of
21 nonpayment remained at all times with assignor).

22 As a result, the FAC states a plausible claim that the March 31 Assignment was a security
23 assignment under the transfer-of-risk test. *Nayab*, 942 F.3d at 496; *S&H Packing*, 883 F.3d at 809.

24
25 _____
26 ²² CAVIC asserts that [“a]ll parties looked to CALLI, not the Debtors, to perform the obligations of the Buyer until
27 delivery of the aircraft.” CAVIC Motion to Dismiss at 16. But there was nothing for them to perform. [REDACTED]

28 [REDACTED] BAC’s proof of claim confirms that fact. Thus, Zetta PTE underwrote that
risk; not CAVIC.

1 **D. The FAC also meets eight-factor test used by the Court in the Dismissal**
2 **Order.**

3 Contrary to CAVIC’s superficial and conclusory analysis, the FAC clarifies that the March
4 31 Assignment is for security under the eight-factor test that the Court applied in the Dismissal
5 Order.

6 **1. Plain Language of the Documents**

7 The plain language of the documents show that the parties intended the March 31
8 Assignment to act as an assignment for security for the repayment of the PDP Loan, rather than an
9 absolute assignment. The entirety of the Transaction Documents, read together, indicate that the
10 PDP Loan was full recourse to the Debtors to enable the Debtors to acquire Plane 5, and the March
11 31 Assignment was to secure the PDP Loan. [*See supra* at 3-10]. The “full recourse” nature of the
12 obligations to the Debtors under the Plane 5 FPA (through exercise of the Notice to Purchase)
13 belies any contention that the March 31 Assignment was an absolute assignment.

14 Specifically, [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED] is

19 flatly inconsistent with, and overrides, the label “absolute” and belies any notion that CAVIC was

20 an actual purchaser (as opposed to a third-party financier) of the rights under the APA. *See U.S. &*

21 *State v. My Left Foot Children’s Therapy, LLC*, 871 F.3d 791, 797 (9th Cir. 2017) (“A standard

22 rule of contract interpretation is that when provisions are inconsistent, specific terms control over

23 the general ones.”) (internal citation omitted). CAVIC’s explanation that Article 10.1 was only

24 inserted based upon the condition that Zetta Jet PTE remain jointly and severally liable, [Dkt. 312

25 at 5], (i) has no textual support in the March 31 Assignment; (ii) is seemingly predicated upon

26 unspecified evidence of negotiating history; and (iii) does not in any way contradict that the core

27 factual proposition that the March 31 Assignment was made for the benefit of a *third party*

28

1 *financier* to enable *Zetta Jet PTE* to acquire Plane 5.

2 CAVIC’s next argument relies on the Court’s statements in its Dismissal Order that “it
3 would be improper for the Court to decide whether the assignment was absolute or for security
4 based upon only two sentences in the [March 31 Assignment], especially when the [March 31
5 Assignment] explicitly states that it was absolute and there are no words or phrases that it was
6 intended as a security agreement” and that there was “no evidence from which the Court could
7 find that the financing . . . was secured.” *See* Dismissal Order at 44.

8 First, the more specific “two sentences” in the Article 10.1 flatly contradict the notion that
9 CAVIC purchased the rights under the Plane 5 APA when it states that Zetta PTE, not CAVIC,
10 was the ultimate intended acquirer of Plane 5. The Court now has the benefit of the specific
11 allegations in the FAC, supported by the Transaction Documents which, read together, show that
12 the March Assignment was part of the larger Plane 5 Financing Transaction under which the
13 Debtors’ obligations to repay the PDP Loan under the integrated Plane 5 FPA were full recourse
14 and that there was no transfer of risk.

15 Nor do the parties’ conclusory labels show that the March 31 Assignment was absolute.
16 For example, the Court relied on the fact that CAVIC signed the Sixth Amendment as “Assignee”
17 and that Zetta PTE was now called the “Original Buyer”, not the Buyer, and only signed the Sixth
18 Amendment as an “acknowledged” and not a direct party. [Dismissal Order at 47-48].

19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED]

23 As discussed below, rather than weighing in
24 favor of an absolute assignment, the Sixth Amendment demonstrates the Debtors could repay the
25 PDP Loan (by reducing the purchase price of Plane 5) through an independent source of recovery,
26 which is one of the eight factors that tends to show a security assignment.

27 Similarly, the Court relied on the inclusion of the term “security assignment” in the Sixth
28 Amendment as an indication that the parties knew how to distinguish between an absolute

1 (Bankr. S.D.N.Y 1984).²³

2 **3. Whether Payments Received Under the Assignment Would be Applied**
3 **to Reduce the Amount of the Loan**

4 It is undisputed that any payments received under the March 31 Assignment would directly
5 reduce the balance of the PDP Loan. That was the entire point of the March 31 Assignment. ■

6 ■
7 ■
8 In the Dismissal Order, the Court focused only on the second step of the Plane 5 Financing
9 Transaction — the repayment of the rolled over balance of the PDP Loan under the Plane 5 Lease.
10 The FAC squarely addresses the documentary basis for the PDP Loan and the Debtors’ obligations
11 to repay it through full recourse provisions of the Plane 5 FPA. [*See supra* at 3-10].

12 **4. Whether the Assignment Will be a Source of Payment if the Loan is**
13 **Not Paid**

14 The right to collect amounts due under the Plane 5 APA was one of the rights assigned to
15 CAVIC under the March 31 Assignment. The parties thus contemplated that the PDP Refund
16 collected under the March 31 Assignment would be source of payment if the Debtors defaulted
17 under the Plane 5 FPA and the Plane 5 FPA Guarantee.

18 In the Dismissal Order, the Court’s sole basis to discount this factor was that there was no
19 evidence of a loan between the Debtors and CAVIC with respect to the PDP Loan. As noted above,
20 the FAC squarely addresses the Transaction Documents that form the basis for the PDP Loan and
21 the full recourse nature of the Debtors’ obligations to repay it.

22 **5. Whether Any Excess Paid on the Loan Will Be Returned to the**
23 **Assignor**

24 Under the Plane 5 FPA, the Debtors repay the PDP Loan through payment the “Purchase
25 Price” in Section 5 of the Plane 5 FPA. [Sch. 2, Ex. 2-63 (Plane 5 FPA), § 5, App’x at A74 - A75].

26 ²³ In ruling on this factor, the Court dismissed this factor on the basis that Zetta was not a borrower making an
27 assignment to a lender. Instead, CAVIC was the borrower and EDC the lender for the PDP Loan. But that loan was
28 not made in a vacuum. Instead, it was part and parcel of the Plane 5 FPA, under which CAVIC in turn loaned that
money to the Debtors to pay the PDP.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]

4 If Bombardier had refunded amounts in excess of the “Purchase Price,” i.e., the payoff
5 amount of the PDP Loan (such as a return of the \$30 million PDP *plus* Zetta PTE’s initial \$1.45
6 million deposit), the Debtors unquestionably would have been be entitled to retain the excess
7 amount. This is because upon payment of the Purchase Price through the Notice of Purchase,
8 CAVIC would have been obligated to re-assign the rights under the APA to the Debtors including
9 any the benefits of any advance payments already made by the Seller in respect of such aircraft.
10 [Sch. 2, Ex. 2-63 (Plane 5 FPA), §§ 2.1, 3.1.2, App’x at A65; A68]. Upon re-assignment, the
11 Debtors would have the full title to the excess payments as re-assignees under the Plane 5 FPA.
12 [Sch. 2, Ex. 2-63 (Plane 5 FPA), § 3, App’x at A67].

13 This factor weighs in favor of the Trustee. *See Paloian v. Lasalle Bank*, 463 B.R. 93 (Bankr
14 N.D. Ill. 2011) (whether the seller has any equitable or legal interests in the assets following
15 transfer (such as a seller’s right to repurchase accounts, a right to excess collections, or a right to
16 alter or compromise the terms of the underlying asset)

17 **6. Whether the Assignee Retains a Right to Deficiency if the Assignment**
18 **Does Not Satisfy the Amount of Debt Owed**

19 The Plane 5 FPA and the Plane 5 FPA Guarantee required the Debtors on a full recourse
20 basis to repay the PDP Loan. If Bombardier defaulted under the Plane 5 APA by failing to deliver
21 Plane 5 and failing to return the full amount of the PDP, CAVIC could exercise the Notice to
22 Purchase and force the Debtors to repay the remaining principal balance, plus interest and other
23 costs, to CAVIC. Thus, CAVIC always retained a right of deficiency against the Debtors if
24 Bombardier – the account debtor – did not honor its obligations under the Plane 5 APA.

25 **7. Whether the Assignee’s Rights in the Assigned Property Would be**
26 **Extinguished if the Assignor Paid the Debt from Another Source**

27 Upon exercise of the Notice to Purchase, the Debtors could repay the PDP Loan from any
28 source of funds. There was no limitation on this right so long as the Debtors paid the Purchase

1 Price.

2 As noted above, after the Purchase Price was paid, CAVIC then had to re-assign all of the
3 rights under the Plane 5 APA. The Dismissal Order recognized that the Debtors, through TVPX,
4 could force CAVIC “to exercise its rights under the PDP Facility Agreement to voluntarily prepay
5 the loan from EDC regarding Aircraft 9788” under the Plane 5 FPA. Dismissal Order at 51. And
6 if the Debtors required CAVIC to exercise its rights, it meant that (i) the Debtors paid to CAVIC
7 all amounts owed by CAVIC to EDC under the PDP Facility Agreement, (ii) the Debtors obtained
8 a payoff statement from EDC, (iii) the Debtors obtained a discharge and release in compliance
9 with Section 4.2 of the Plane 5 FPA, and, (iv) as a result, CAVIC would be forced to transfer the
10 Aircraft Interests back to the Debtors. [Sch. 2, Ex. 2-63 (Plane 5 FPA), §§ 2.2.2 (“The Buyer
11 [TVPX] shall be entitled to issue a notice [to sell] to the Seller [CAVIC] at any time requiring the
12 Seller to sell an Aircraft Interest to the Buyer if . . . the Buyer requires the Seller to exercise its
13 rights under the Facility Agreement to voluntarily prepay the loan in respect of the applicable
14 Aircraft”); 4.2 (“The obligation of the Seller to sell an Aircraft Interest and to assign its rights
15 under the applicable Purchase Agreement . . . is subject to” the three payoff conditions), App’x at
16 A66; A69].

17 Moreover, the Debtors paid interest from its own funds, which reduced obligations under
18 the PDP Loan. [FAC ¶ 82]. [REDACTED]

19 [REDACTED]
20 [REDACTED] which
21 also demonstrates that the Debtors could extinguish CAVIC’s rights through other sources of
22 payment.

23 **8. Whether Before the Complaint Was Filed, the Assignee Filed Proofs of
24 Claims or Other Documents Asserting That It Was a Secured Party**

25 On April 24, 2018, CAVIC filed the CAVIC POCs relating to the Plane 5 APA and March
26 31 Assignment. [Composite Ex. 5]. In these proofs of claim, CAVIC acknowledged that the
27 Debtors were obligated to pay interest on the Plane 5 PDP Loan pursuant to Section 6.1.1 of the
28

1 Plane 5 FPA and Plane 5 FPA Guarantee. *Id.* Post-assignment payment of interest by a debtor on
2 an advance made in exchange for a supposed “absolute” assignment of a contract right is a factor
3 weighing in favor of a security assignment. *See Major’s Furn. Mart*, 602 F.2d at 545.

4 CAVIC also asserted that some or all of its claim against the Debtors is secured.
5 [Composite Ex. 5]. The only way the claim could be secured, however, would be if the March 31
6 Assignment was for security. There is no other transaction document under which CAVIC’s claim
7 for interest under the Plane 5 FPA could have been secured. The Court’s conclusion that CAVIC’s
8 inconsistent statement in the same proof of claim regarding an “absolute” assignment and that
9 CAVIC “never wavered” impermissibly construed competing inferences in CAVIC’s favor.

10 **II. The choice-of-law provisions in the Plane 2-4 Finance Leases do not affect the**
11 **Trustee’s recharacterization claims (Count I).**

12 CAVIC argues that the Plane 2-4 Finance Leases cannot be recharacterized under English
13 law. [Dkt. 312 at 11]. This is irrelevant, because English law does not govern the Plane 2-4 Finance
14 Leases, which are governed by California law. However, even if English law controlled, the Plane
15 2-4 Finance Leases would be treated as finance leases.

16 **A. California law governs the Plane 2-4 Finance Leases and requires**
17 **recharacterization.**

18 CAVIC, citing the Dismissal Order, incorrectly argues that the choice-of-law analysis leads
19 to English law. [Dkt. 312 at 11]. CAVIC summarizes the Dismissal Order to argue that the Ninth
20 Circuit applies federal common law choice of law rules, which follow the Restatement (Second)
21 of Conflicts of Laws (the “Restatement”). CAVIC then incorrectly applies section 187(1) of the
22 Restatement to conclude that the chosen law need not have any reasonable relationship to creation
23 or performance of the contract, so English law governs the Plane 2-4 Finances Leases
24 notwithstanding the lack of any relationship between the finance leases and England. [Dkt. 312 at
25 12-13].

26 The Trustee does not dispute that the Ninth Circuit applies federal common law choice of
27 law rules, which follow the Restatement. However, CAVIC’s argument is fundamentally flawed
28 because the Court, in the Dismissal Order, applied the incorrect section of the Restatement. The

1 relevant section here is not 187, but 6(1). Section 6(1) states that “[a] court, subject to constitutional
2 restrictions, will follow a statutory directive of its own state on choice of law.” Section 187(1)
3 provides a *default* rule regarding application of a contractual choice of law when there is *no*
4 statutory directive.

5 Here, there is a statutory directive: section 1301 of the California Commercial Code (the
6 “CCC”). The CCC governs all transactions involving the sale or lease of personal property. *See*
7 CCC Division 2 (governing sales); CCC Division 10 (governing personal property leases); *see*
8 *also In re Eagle Enters., Inc.*, 223 B.R. 290, 293 (Bankr. E.D. Pa. 1998) (noting that
9 Pennsylvania’s Commercial Code “expressly makes . . . choice of law decisions inapplicable to
10 issues concerning the perfection of security interests under [Pennsylvania’s Commercial Code];”
11 *Carlson v. Tandy Comput. Leasing*, 803 F.2d 391, 393-94 (8th Cir. 1986) (noting a limitation on
12 parties’ choice of law under Missouri’s UCC, which provides that article 9 shall apply to any
13 transaction intended to create a security interest in personal property within Missouri, including “a
14 lease intended as security.”).

15 Section 1301 of the CCC, regarding contractual choice of law, is exactly the type of
16 “statutory directive” contemplated by Section 6(1) of the Restatement. *See In re Gibson*, 234 B.R.
17 776, 789 (Bankr. N.D. Cal. 1999); *see also Turner v. Aldens, Inc.*, 433 A.2d 439 (N.J. Sup. Ct.
18 1981) (applying a statutory directive regarding choice of law notwithstanding a contrary election
19 under the contract at issue). Indeed, the official commentary to section 6(1) specifically refers to
20 *the UCC* as an example of where a statute directs the choice of law of a particular state.²⁴ Courts
21 have held that official comments to uniform codes are useful in interpreting such codes. *See In re*
22 *Commercial Money Center, Inc.*, 350 B.R. 465, 474 (B.A.P. 9th Cir. 2006) (“Like other courts we
23 recognize the usefulness of the Official Comments in interpreting the UCC.”) (citing *In re*
24 *Filtercorp., Inc.*, 163 F.3d 570, 580 (9th Cir. 1988)).

25
26 24 “The court must apply a local statutory provision directed to choice of law provided that it would be constitutional
27 to do so. An example of a statute directed to choice of law is the Uniform Commercial Code which provides in certain
28 instances for the application of the law chosen by the parties (§ 1-105(1)) and in other instances for the application of
the law of a particular state (§§ 2-402, 4-102, 6-102, 8-106, 9-103.” Rest. 2d Confl. § 6, Comment on Subsection (1).

1 Under Section 1301(a), when a transaction bears a “reasonable relation” to a state or nation,
2 the parties may agree that the laws of that state or nation govern. Under subsection (b), where there
3 is no effective agreement under (a), the CCC governs so long as California bears an appropriate
4 relation to the transaction. The “reasonable relation” test of Section 1301 is far more stringent than
5 that of Section 187, which the Court’s applied in the Dismissal Order (that now CAVIC re-adopts
6 in its Motion) to uphold the parties’ choice of English law provisions in the Plane 2-4 Finance
7 Leases. The “reasonable relation” test was designed to be stringent because drafters of the UCC
8 (on which the CCC provision is based) were “concerned that the parties in a Code state might try
9 to circumvent the application of the UCC by choosing the law of a different jurisdiction,” so the
10 drafters “tried to put a damper on this potentially pernicious kind of evasion by limiting it to those
11 states having a reasonable relationship to the transaction.” 1 Hawkland UCC Series § 1-301:1.
12 While the drafters “did not specifically define ‘reasonable relationship,’” an official comment
13 adopted the meaning developed by the United States Supreme Court in a case involving this
14 problem, *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 47 S. Ct. 626, 71 L. Ed. 1123
15 (1927).” See UCC §1-301, Official Comment 1 (“In general, the test of “reasonable relation” is
16 similar to that laid down by the Supreme Court in [Seeman].”). In *Seeman*, the Supreme Court
17 limited freedom to contract on choice of law by requiring that governing law have (1) “a natural
18 and vital connection with the transaction” and (2) be made in good faith and not to disguise its
19 character. *Seeman*, 274 U.S. at 408.

20 Here, CAVIC asserts no basis for the application of English law other than that the parties
21 “are from all over the world” and that “international financing and leasing contracts are often
22 governed by English law.” [Dkt. 312 at 13]. That may be sufficient under the different, more
23 lenient “reasonable basis” test of Section 187(2), but it is not enough under the correct “reasonable
24 relationship” test under the CCC. England has *no* relationship to the parties or the Planes 2-4
25 transactions, much less a *reasonable relationship*, and the contractual choice of law of England
26 should be disregarded by the Court. None of the parties to the Plane 2-4 Finance Leases resides in
27 England, is incorporated or organized under English law, or has its principal place of business in
28

1 England. The place of payment was not in England, but rather CAVIC's bank account in China,
2 and payments were denominated in US dollars, not pounds sterling. The planes were manufactured
3 in Canada and delivered to the Debtors in the United States, the closings occurred in the United
4 States, and none of the parties were located in England at the time the finance leases were executed.
5 In short, the Plane 2-4 Finance Leases bear no connection to England whatsoever, let alone a
6 "natural and vital connection." Accordingly, the English choice of law provision is ineffective and
7 California law applies under Section 1301(b).²⁵

8 **B. Application of Restatement Section 187(2) would not change the**
9 **conclusion that California law applies.**

10 As noted above, rather than apply the more exacting CCC test, the Dismissal Order
11 incorrectly applied Section 187(1) of the Restatement. The Court alternatively found in a footnote
12 that, even if Section 187(2) of the Restatement were to apply, the result would be the same, citing
13 *In re Zukerkorn*, 484 B.R. 182 (B.A.P. 9th Cir. 2012). Under Section 187(2), the chosen law will
14 be applied to the transaction unless the chosen law has "no substantial relationship to the parties
15 or the transaction *or* there is no other reasonable basis for the parties' choice." The Court noted
16 that *Zukerkorn* applied a "reasonable basis" analysis to the choice of law provision at issue, a
17 "minimal standard." [Dkt. 168 at 18]. The Court determined that a "reasonable basis" existed for
18 application of English law "because the parties to the transactions here are from all around the
19 world" and, citing a periodical, further noted that "international aircraft financing and leasing
20 transactions are often governed by English law." *Id.* Further, the court found that California did
21 not have a "fundamental policy" that would be offended by enforcement of Hawaiian law, and that
22 California did not have a materially greater interest in the issue at hand. *Zukerkorn*, 484 B.R. at
23 194.

24 *Zukerkorn* does not apply here for the simple reason that *Zukerkorn* involved a spendthrift

25 ²⁵ For the same reasons, Section 1301(c) of the CCC is a statutory directive under Section 6(1) of the Restatement and
26 mandates that the parties' contractual choice of law be disregarded in the context of determining whether the Planes
27 2-4 Leases are leases or security interests. *See* CCC 1203 (defining "security interest" and listing factors relevant to
28 whether a security interest has been created). Read together, these provisions require application of California law in
the recharacterization context. *See In re Eagle Enters., Inc.*, 223 B.R. 290, 293 (Bankr. E.D. Pa. 1998) (performing
this analysis under the corresponding provisions of Pennsylvania law). [*See also* Dkt. 75, at 9-10].

1 trust, not a lease or security interest transaction subject to the CCC. *See id.* at 185-86. Thus, there
2 was no statutory directive that required the more exacting “reasonable relationship test” as is the
3 case here.²⁶

4 **C. Even if English law applied, the Plane 2-4 Finances Leases are still**
5 **finance leases, not operative leases, and English courts would treat them**
6 **as such.**

7 As more fully set forth in the Declaration of Rosalind Phelps QC, attached as Exhibit 3
8 (“Phelps Decl.”), contrary to CAVIC’s assertions, applicable English law would characterize the
9 transactions as finance leases, not operating leases, and would not negate the Debtors’ actual
10 economic ownership of Planes 2-4.

11 Importantly, in the Dismissal Order, the Court cited an English law textbook to note that
12 England takes a “formal” approach to recharacterization, in contrast to the American “functional”
13 approach. *See* Dismissal Order, at 19; Phelps Decl., ¶ 30. However, the very same passage goes
14 on to note that, despite a generally formal English approach, “if the document is a true record of
15 the agreement but its terms indicate that its legal character is not that ascribed to the parties — as
16 where a transaction described as a lease is in fact a conditional sale — **the courts will disregard**
17 **the label attached by the parties and look at the legal substance**” (emphasis added). Phelps
18 Decl., ¶ 31. That is precisely what an English court would do here. Phelps Decl., ¶ 45.

19 In sum, English law distinguishes between finance leases and operating leases, with a
20 finance leases transferring substantially all of the risks and rewards of ownership of an asset to the
21 lessee, whereas in an operating lease, the risks and rewards of ownership remain with the lessor.
22 English law would thus characterize the Plane 2-4 Finance Leases as financing arrangements
23 because, among other things:

- 24 • All the risks and rewards of ownership were transferred to the Debtors;

25 ²⁶ In addition, application of English law to deny recharacterization violates fundamental policy of US bankruptcy law
26 and federal common law that imposes guardrails prohibiting the elevation of form over substance in determining the
27 economic realities of supposed “lease” transactions and empowering a trustee to recover fraudulent transfers of estate
28 property for the benefit of creditors. *See United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609 (7th Cir. 2005)
(finding that “every appellate court that has considered the issue holds, and the parties agree, that substance controls
and that only a ‘true lease’ counts as a ‘lease’” for purposes of Section 365 of the Bankruptcy Code).

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[REDACTED]

Accordingly, the Plane 2-4 Finance Leases are finance leases under English law and do not alter the Debtors’ actual economic ownership interest of Planes 2-4.²⁷

III. The Court should grant leave to replead if the FAC is dismissed in whole or in part.

The Complaint states each claim alleged, but even if it did not, the proper remedy here would be a dismissal without prejudice and with leave to replead, particularly if the Court were to dismiss the FAC for a reason that was not raised in the first round of briefing or fully addressed in the Dismissal Order. Leave to amend should be granted unless the court “determines that the pleading could not possibly be cured by the allegation of other facts.” *Lopez v. Smith*, 203 F.3d 1122, 1127 (9th Cir. 2000) (en banc); *Bly–Magee v. California*, 236 F.3d 1014, 1019 (9th Cir. 2001) (holding that when dismissing for failure to comply with Rule 9(b) “leave to amend should be granted unless the district court determines that the pleading could not possibly be cured by the allegation of other facts”); *see also Knevelbaard Dairies v. Kraft Foods, Inc.*, 232 F.3d 979, 983 (9th Cir. 2000) (“An order granting [a motion to dismiss] must be accompanied by leave to amend unless amendment would be futile”).

CONCLUSION

The Trustee thus respectfully requests that the Court deny the Defendants’ Motions to

²⁷ The Trustee reserves all rights to amend and supplement his arguments in favor of recharacterizing the Plane 2-4 Finance Leases, including those set forth in prior pleadings in this Adversary Proceeding.

1 Dismiss the First Amended Complaint.²⁸

2 Respectfully submitted,

3 DATED: October 8, 2021 **DLA PIPER LLP (US)**

4
5 /s/ John K. Lyons

6 David B. Farkas (SBN 257137)
7 John K. Lyons (*pro hac vice*)
8 Jeffrey S. Torosian (*pro hac vice*)
9 Joseph A. Roselius (*pro hac vice*)

10 *Counsel for the Chapter 7 Trustee*

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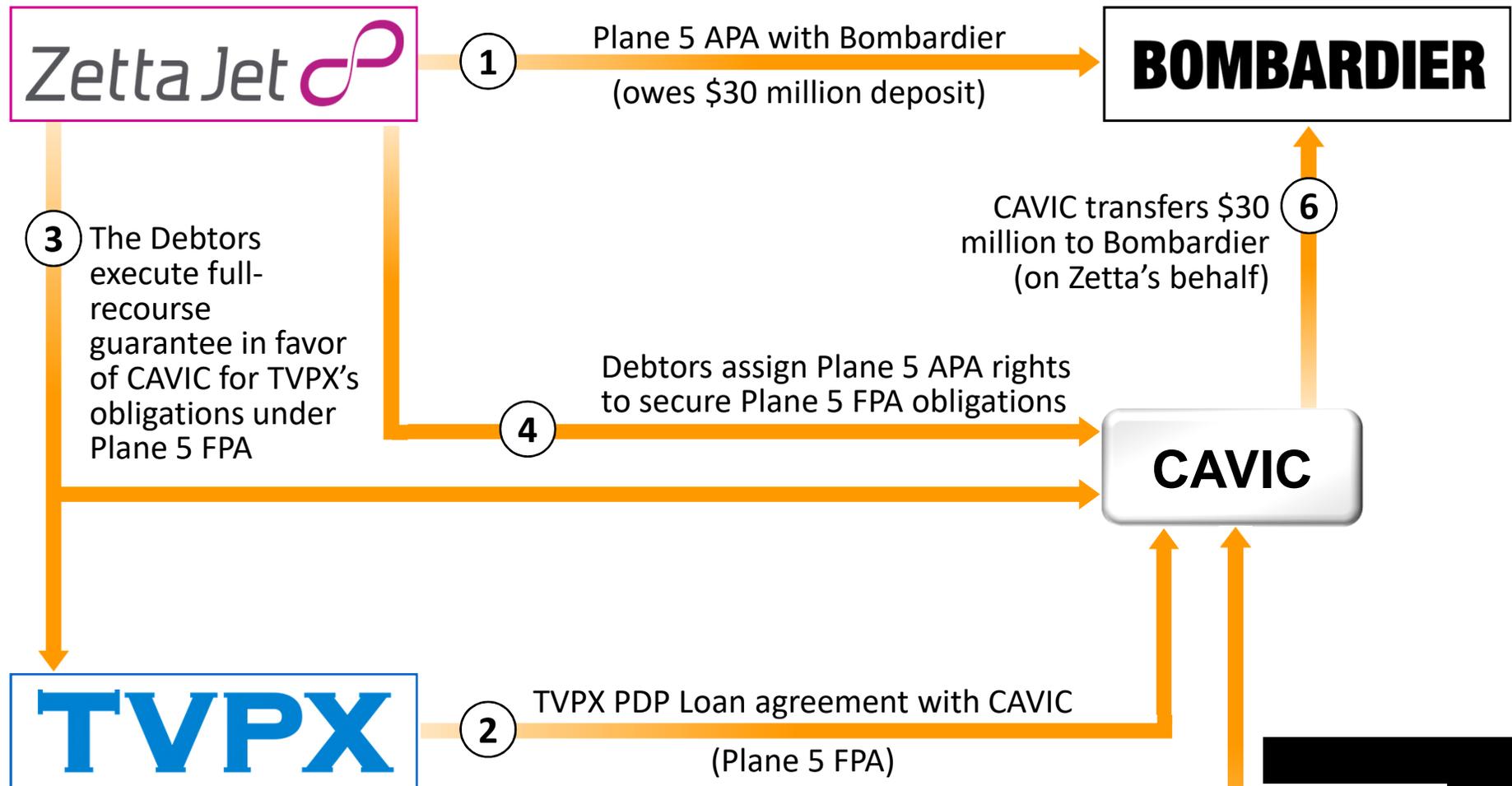
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²⁸ To the extent the Trustee has not addressed an issue raised or ruled upon by the Court in the Dismissal Order or the Court's July 13, 2021 Memorandum of Decision on "Motion For Leave To Amend Adversary Complaint," Docket #242, Filed by Chapter 7 Trustee Jonathan D. King" [Adv. Docket No. 275], the Trustee does not intend to and does not waive or forfeit any claims or arguments raised by the Trustee in connection with, or any right to appeal, the Dismissal Order or other decisions with respect to the pleadings, including without limitation the Court's denial of consolidation and the Court's denial of the Trustee's motion to compel BAC to deposit the \$30 million PDP with the Court.

Exhibit 1

PDP Loan Financing Transaction



- (1) Plane 5 APA [Sch. 2, Ex. 2-53]
- (2) Plane 5 FPA [Sch. 2, Ex. 2-63]
- (3) Plane 5 FPA Guarantee [Sch. 2, Ex. 2-64]
- (4) March 31 Assignment [Sch. 2, Ex. 2-70]
- (5) PDP Facility Agreement [Sch. 2, Ex. 2-58]



Exhibit 2

Plane 5 Financing Lease Transaction

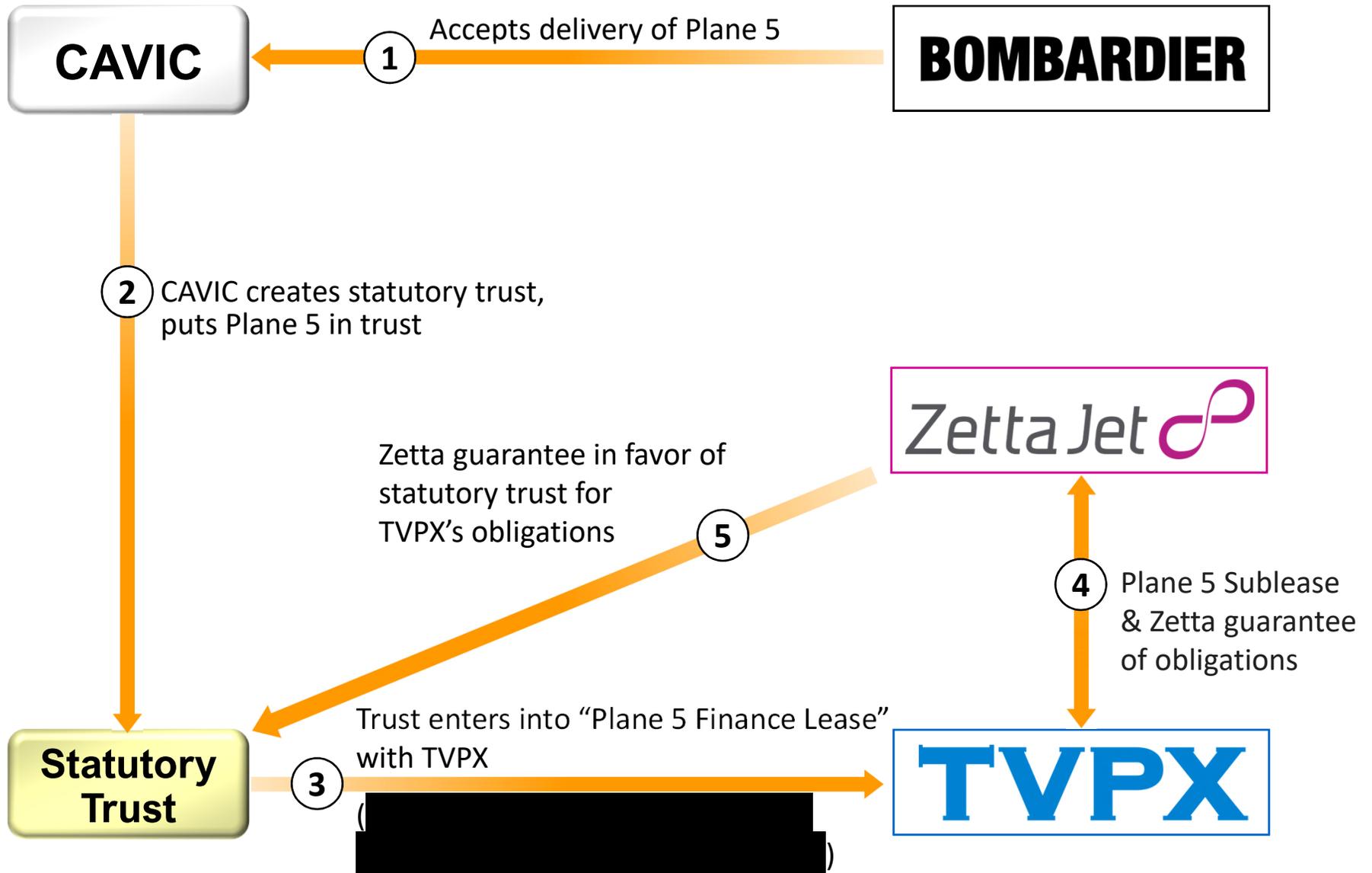


Exhibit 3

IN RE ZETTA JET USA INC and ZETTA JET PTE, LTD

OPINION OF ROSALIND PHELPS QC

Introduction

1. I am instructed by the Chapter 7 Trustee of Zetta Jet USA Inc (a Californian Corporation) and Zetta Jet PTE Ltd (a Singaporean corporation) (together **Zetta Jet**) to provide an expert opinion for the purposes of proceedings currently ongoing in the United States Bankruptcy Court, Central District of California, Los Angeles Division.
2. I am a senior barrister (Queen’s Counsel or QC) qualified in England and Wales, with substantial experience in both aviation and banking and finance matters. I practise from Fountain Court Chambers in London which is ranked in Band 1 by both the Legal 500 and Chambers & Partners for Aviation and Banking. I was appointed QC in 2016. My relevant experience and qualifications are set out in Annexe 1.
3. Zetta Jet was a private jet charter business which filed for Chapter 11 bankruptcy on 15 September 2017. The Chapter 11 cases were converted to Chapter 7 proceedings in December 2017. The Trustee has filed an Amended Adversary Complaint in Case No. 2:17-bk-21386-SK against a number of defendants including CAVIC Aviation Leasing (Ireland) 22 Co. Designated Activity Company (**CAVIC**), Bombardier Aerospace Corporation (**BAC**) and three statutory trusts (ZJ6000-1, ZJ6000-2 and ZJ6000-3 Statutory Trusts).
4. The Trustee seeks (i) a declaratory judgment that the leases relating to three Bombardier Global 6000 Aircrafts with serial numbers 9716, 9740 and 9764 (respectively, **Planes 2**,

3 and 4) are finance leases rather than “true” or operating leases and (ii) to recover a US\$30 million pre-delivery payment made in relation to a further aircraft (Plane 5).

5. The key contracts for present purposes are the leases (the **Aircraft Lease Agreements**) detailed below:

a. An Aircraft Lease Agreement dated 24 May 2016 between ZJ6000-1 Statutory Trust as Lessor and TVPX ARS Inc as Owner Trustee as Lessee in relation to Bombardier aircraft MSN 9716 (**Plane 2 ALA**).

b. An Aircraft Lease Agreement dated 16 September 2016 between ZJ6000-2 Statutory Trust as Lessor and TVPX ARS Inc as Owner Trustee as Lessee in relation to Bombardier aircraft MSN 9740 (**Plane 3 ALA**).

c. An Aircraft Lease Agreement dated 24 May 2016 between ZJ6000-3 Statutory Trust as Lessor and TVPX ARS Inc as Owner Trustee as Lessee in relation to Bombardier aircraft MSN 9764 (**Plane 4 ALA**).

6. Each Aircraft Lease Agreement contains a clause providing that it is governed by English law (clause 32.1).

7. I am instructed that:

a. The Aircraft Leases formed part of a complex structure of agreements whereby, essentially, finance was provided by CAVIC for Zetta Jet’s purchase of the aircraft from the manufacturer, Bombardier Inc.¹

b. The lessor under the Aircraft Leases was a Statutory Trust (ZJ6000-1, 2 or 3) of which CAVIC was the trustor (and the true interested party).

c. Each of the aircraft was in turn sub-leased by TVPX ARS Inc to Zetta Jet USA Inc as operator.

d. If the Aircraft Lease Agreements are recharacterized as secured financings, that will enable the Trustee to argue that Zetta Jet has an economic interest giving rise

¹ It appears from the Aircraft Lease Agreements that Zetta Jet PTE Ltd had entered into agreements to purchase each aircraft, and that those agreements were assigned to the lessor (see the definition of “Purchase Agreement” in Schedule 2).

to proprietary rights in Planes 2, 3 and 4 for the purposes of certain claims under the Bankruptcy Code.

8. I am instructed that under US law, “[w]hether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.” (Uniform Commercial Code 1-203(a), California Commercial Code 1203(a)). The first stage of the test is whether the debtor/lessee can terminate the agreement during its term. If not then courts look to the “residual value factors” in UCC § 1-203 (b) (or the relevant state's equivalent). The residual factors are said to be: (1) the original term of the lease is equal to or greater than the remaining economic life of the goods; (2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; (3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or (4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.
9. The Defendants have issued a motion to dismiss certain counts of the amended adversary complaint on a number of bases, including contesting the recharacterisation of the Aircraft Lease Agreements. Under a previous decision dated 7 October 2020 (**Dismissal Order**) the court decided that under English law the Aircraft Lease Agreements would be viewed as leases under English laws and could not be recharacterized under English law. The court relied on the case of HFGL Ltd & CNH Cap Europe Ltd v Alex Lyon & Con Sales Managers and Auctioneers Inc 700 F Supp.2d 681 as authority for the proposition that under English law a lessor retains ownership of goods unless a hire purchase agreement option to purchase is exercised. It therefore decided that the leases could not be recharacterized for the purposes of US law.
10. I am asked to consider (i) the treatment of the leases from an English law perspective; (ii) how English law would distinguish between operating leases and finance leases; and (iii) what effect English law could have on the proceedings in the Californian court and in particular whether English law would prevent the leases from being re-characterised as a security interest under US insolvency laws.

Summary of my opinion

11. I regard the issues of (i) how to approach the question of recharacterisation of the Aircraft Lease Agreements for the purposes of the US bankruptcy proceedings and (ii) the relevance or otherwise of English law to that issue as questions for the Californian court.
12. As regards how English law would approach the characterisation question:
 - a. English law does not make a clear, formalistic distinction for all purposes between a sale or finance lease and a hire purchase or operating lease.
 - b. There is nothing in English law which would prevent the recharacterisation by the Californian court of the Aircraft Lease Agreements as a form of borrowing or financing; indeed English courts frequently undertake such an exercise themselves.
 - c. Under English law, the Aircraft Lease Agreements bear many key hallmarks of finance leases as opposed to “true” or “operating” leases and the English Court would likely describe them as such if the question arose for its consideration.

Recharacterisation of contracts under English law: general principles

13. English law principles are mainly to be found in statutory law and case precedent and many of the rules relating to the ownership, leasing and taking security over aircraft are to be found in applicable case law. It is also correct to say that there is no statutory law relating to the recharacterisation of leases akin to those in the US law provisions I have described above. However, as I explain below, that does not mean that English courts would shy away from characterising a document described as a “lease” as truly a finance lease, or indeed as a form of borrowing.
14. The question of when and to what extent a court will recharacterise a transaction or document as something different from its label depends on the relevant context:

This does not mean that the terms which the parties have adopted are necessarily determinative. The substance of the parties' agreement must be found in the language they have used; but the categorisation of a document is determined by the legal effect which it is intended to have, and if when properly construed the effect of the document as a whole is inconsistent with the terminology which the parties have used then their ill-chosen language must yield to the substance.

The legal classification of a transaction is not, therefore, approached by the Court *in vacuo*. The question is not what the transaction is but whether it is in truth what it purports to be. Unless the

documents taken as a whole compel a different conclusion, the transaction which they embody should be categorised in conformity with the intention which the parties have expressed in them.²

15. It is important to note a number of matters in this regard:

a. The court first construes the relevant documents to understand what obligations and rights the parties intended. The second stage is one of categorisation; if the intention of the parties was to impose obligations and create rights which are inconsistent with the contract's label then the contract will not be construed in accordance with that label.³

b. This exercise does not take place in a vacuum; there is always a legal context against which the recharacterisation arguments are being made. Put simply, there must be a reason for the question of recharacterisation to be asked. The reason is typically to establish whether a contractual arrangement is a type to which a special regime applies under English law or for which English law imposes particular formalities or implied particular terms.

16. In the present case, the legal context in which the recharacterisation arguments will arise is the adversary complaint summarised above and in particular the question of whether the Aircraft Lease Agreements are to be characterised as leases or security interests. English insolvency law has no analogue to section 1203 of the California Commercial Code and so the question of recharacterising leases in that context does not arise. Indeed, UK insolvency legislation treats the owners of property and owners of security interests in a similar way when a company enters administration, there is therefore no need to distinguish between the two for these purposes.⁴

17. Nevertheless the English courts frequently consider the true characterisation of documents in other contexts order to decide whether particular legal consequences should follow. In particular, the English courts are perfectly willing to decide that a document

² Orion Finance Ltd v Crown Financial Management Ltd [1996] BCC 621 (Millet LJ).

³ See e.g. Brumark Investments Limited: Agnew v Commissioner of Inland Revenue [2001] UKPC 28, at [31]: “[categorisation of the contract] is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it”.

⁴ Re Atlantic Computer Systems [1992] Ch 505, 527. Furthermore, an airline's interests in leased aircraft have been described as “property” of the company for the purposes of the Insolvency Act 1986 (such that the administrators' consent was required for an airport to exercise liens over the aircraft): Bristol Airport plc v Powdrill [1990] Ch 744, 759.

with a particular label (including that of “lease”) should be treated as if it were indeed a different type of transaction. For example:

- a. In a company insolvency, much may turn on whether a creditor’s charge over assets is a fixed charge or a floating charge. In a House of Lords decision from 2005 the court recharacterised a specific or fixed charge as a floating charge notwithstanding the clear label used by the parties:

Both sides agree that the label of "fixed" or "specific" (which I take to be synonymous in this context) cannot be decisive if the rights created by the debenture, properly construed, are inconsistent with that label ...Whether or not it is appropriate to describe this by some disparaging term such as camouflage, it is the court's duty to characterise the document according to the true legal effect of its terms, as has been very clearly explained by Lord Millett in *Agnew's case* [2001] 2 AC 710 , 725-726, para 32. In each case there is a public interest which overrides unrestrained freedom of contract.

In re Spectrum Plus Ltd (in liquidation) [2005] 2 AC at [141] per Ld Walker of Gestinghope.

- b. Different legal consequences follow from whether an arrangement for the occupation of land in exchange for rent is to be characterised as a lease or a licence. In this regard the label used by the parties is not conclusive and the courts will closely examine the relevant contractual terms in order to decide the proper characterisation of the transaction. In the leading House of Lords decision it was put this way:

Both parties enjoyed freedom to contract or not to contract and both parties exercised that freedom by contracting on the terms set forth in the written agreement and on no other terms. But the consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence. The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.

Street v Mountford [1985] AC 809, 819, per Ld Scarman.

- c. The equitable remedy of relief from forfeiture is available for certain types of leases of land or chattels where the rights forfeited are proprietary or possessory in nature. In this regard, the courts will consider carefully the terms of the relevant lease to decide whether the rights granted under the leases qualify for this sort of assistance from the court, whatever label has been given to it by the parties. In this regard the distinction between a “true” or operating lease of chattels on the one hand and a “finance” lease on the other may be highly relevant, since a lessor under finance lease is more likely to have the appropriate proprietary rights. The

relevant cases, including in relation to aircraft, are considered further in paragraphs 20-25 below.

- d. Certain English public authorities do not have the power to borrow money. The courts will therefore scrutinise transactions, including lease arrangements, in this context to see whether in substance they amount to loans. This is discussed further in paragraph 26 below.

18. The English court (i) will not be hidebound by the label attached to the transaction if the context requires looking behind it and (ii) in certain cases the extent and nature of a transaction's legal obligations and its economic effect are intertwined such that the court does indeed consider the economic impact of the contract.

19. There is therefore no obstacle to the English court considering both the legal and economic effect of an aircraft lease and deciding whether it is a "true" or operating lease or a form of financing, if that is what the context requires. In the next section I consider the distinction drawn by the English Courts between these two concepts, and demonstrate how it is applied in practice.

Distinction between operating leases and finance leases

The English Courts recognise the distinction

20. The distinction between an operating lease and a finance lease has been described as "fundamental" by the leading textbook on English commercial law.⁵ The following description of the difference has been approved by the Court of Appeal in the leading case of On Demand Information PLC v Michael Gerson (Finance PLC) [2001] WLR 155

Leases and hire purchase contracts are means by which companies obtain the right to use or purchase assets. In the UK there is normally no provision in a lease contract for legal title to the leased asset to pass to the lessee.

A hire purchase contract has similar features to a lease except that under a hire purchase contract the hirer may acquire legal title by exercising an option to purchase the asset upon fulfilment of certain conditions (normally the payment of an agreed number of instalments).

Current tax legislation provides that in the normal situation capital allowances can be claimed by the lessor under a lease contract but by the hirer under a hire purchase contract.

⁵ *Goode and McKendrick on Commercial Law* by Professor Ewan McKendrick, Professor of English Private Law at the University of Oxford (6th ed) at paragraph 28.03.

....

Forms of Lease

Leases can appropriately be classified into finance leases and operating leases. The distinction between a finance lease and an operating lease will usually be evident from the terms of the contract between the lessor and the lessee.

An operating lease involves the lessee paying a rental for the hire of an asset for a period of time which is normally substantially less than its useful economic life. The lessor retains most of the risks and rewards of ownership of an asset in the case of an operating lease.

A finance lease usually involves payment by a lessee to a lessor of the full cost of the asset together with a return on the finance provided by the lessor. The lessee has substantially all the risks and rewards associated with the ownership of the asset, other than the legal title. In practice all leases transfer some of the risks and rewards of ownership to the lessee, and the distinction between a finance lease and an operating lease is essentially one of degree.”

21. The leading textbook on contract law, *Chitty on Contracts* (cited with approval in On-Demand Information) describes finance leasing as “*a form of long-term financing*” where

the lessee selects the equipment to be supplied by a manufacturer or dealer, but the lessor (a finance company) provides the funds, acquires title to the equipment and allows the lessee to use it for all (or most) of its expected useful life. During the period of the lease the usual risks and rewards of ownership are substantially transferred to the lessee, who bears the risks of loss, destruction and depreciation of the leased equipment (fair wear and tear only excepted) and of its obsolescence or malfunctioning. The lessee also bears the costs of maintenance, repairs and insurance. The regular rental payments during the primary period of the lease are calculated to enable the lessor to amortise its capital outlay and to make a profit from its finance charges. ... The bailment which underlies finance leasing is therefore only a device to provide the finance company with a security interest (its reversionary right); a finance lease is similar in function to outright purchase or hire purchase.⁶

22. In the On-Demand Information case, the leases were of computer equipment and had a primary term of 36 months. The lessee paid a substantial quarterly rent which, by the end of the period, was sufficient to cover the lessor’s costs of the equipment as well as interest and profit. The lessee could continue the lease for a single modest payment on expiry of the primary period, and was also not permitted to terminate the lease before this point. The court rejected the lessor’s submission that the leases granted purely contractual rights; it said that these were finance leases, that the lessor’s interest was purely financial and that the leases were in the nature of a security such that there could be relief from forfeiture:

Michael Gerson's real interest in the finance leases was a financial interest. To say that is not to disregard legal rights and obligations in favour of economic substance (as to which see Robert Goff LJ in *Bank of Tokyo v Karoon* (1984) [1987] AC 45, 64). It is a legitimate

⁶ *Chitty on Contracts*, 33rd ed, paragraph 33-084.

consideration if On Demand is to satisfy one or other of the conditions stated by Lord Wilberforce in Shiloh Spinners [*i.e. the conditions for relief from forfeiture*].

23. That conclusion was reached notwithstanding that the leases were not expressly labelled “finance leases”.

Application of the distinction to aircraft leases

24. The question of whether the lessors under aircraft leases could benefit from relief from forfeiture was considered by the Commercial Court in Celestial Aviation Trading 71 Limited v Paramount Airways Private Ltd [2010] EWHC 185 Comm.⁷ The leases in question had an 8 year term, but there was no right for the lessee to purchase the aircraft at the end of the term.

25. The court noted at [50] – [51] that an option to purchase gives rise to a “*proprietary or expectant proprietary right*”, which was absent here. The lessor in this case retained a very real interest in the aircraft, including their condition and the residual rental and resale value. Moreover, it was significant that the rent was not calculated on the basis of recouping the cost of the aircraft together with interest and profit. It concluded at [56] that these were operating leases, not finance leases (and that there was no right to relief from forfeiture).

Courts do recharacterise a financing labelled an “operating lease” as disguised borrowing

26. In the recent case of School Facility Management v Governing Body of Christ the King College [2020] EWHC 1118 (Comm) the court found that certain leases of modular buildings were *ultra vires* the school lessee and void because the school lacked the power to borrow money. Relevantly for present purposes, the court found as follows:

- a. As a matter of ordinary English, the leases would not be described as loans ([168], [176]).
- b. The question of whether the leases amounted to borrowing (and were thus beyond the school’s powers) “*cannot turn on how the transaction is structured or labelled, but must involve consideration of the economic substance of the transaction*”. Unless this approach was followed, the intended legislative controls

⁷ A decision of Hamblen J, who is now a Supreme Court judge.

on borrowing would be circumvented ([179]). Furthermore, “*the issue of whether the Contract constituted borrowing is, in the final analysis, a question for the Court on the evidence before it, the status of the lease to be determined at the time it is concluded*” ([190]).

- c. The evidence showed that the relevant accounting standards for public bodies treated finance leases as borrowing for accounting purposes. The key question was whether the lease transferred substantially all the risks and rewards incidental to ownership to the lessee. The following factors would, individually or in combination, lead to a classification as a finance lease: (a) the lease transfers ownership of the asset to the lessee by the end of the term; (b) the lessee has an option to purchase the asset at a lower price than the expected fair value of the asset; (c) even if title is not transferred, the lease term is for the major part of the economic life of the asset; (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications ([180] – [185]).
- d. The court carefully examined the features of the lease. Factors (a) and (b) were not present but factors (c), (d) and (e) all were. The lease was therefore a finance lease and constituted borrowing for the purposes of the exercise of the school’s powers ([198] – [250]).
- e. This conclusion was reached notwithstanding that the contract described itself as an operating lease – “*the parties’ own descriptions cannot be decisive of an issue which turns on the economic substance of the transaction*” ([252]).

27. It certainly would not be correct to say that the economic realities or commercial effect would not be relevant as a matter of English law, or that features such as a nominal purchase option would be insufficient to justify the recharacterisation of the leases as a matter of English law. In the School Facility Management case, the court ignored the operating lease label and considered the economic effect of the transaction in order to decide if it indeed was a true lease or something else.⁸ As I understand it, that is precisely

⁸ It is notable that the court concluded that the leases were finance leases notwithstanding the absence of ownership transfer or an option to purchase, which would have put the matter beyond doubt.

the approach the US court would take in applying UCC 1-203(a), albeit applying different factors. English law is no obstacle to this. Nor, notably, had the option to purchase been exercised in that case.

The Dismissal Order and HFGL case

28. I do not consider that the HFGL case cited in the Dismissal order is any obstacle to the above conclusion. That was a decision on a motion for summary judgment about whether HFGL, a lessor of hire purchase goods, was entitled to bring a claim for conversion as owner of the goods. The court cited some authority for the argument that unless the lessee exercised the option to purchase, HFGL retained ownership of them under English law (although the motion was apparently denied because there were disputed questions of fact regarding the threshold question of ownership). It is unclear to me from the report of that decision what were the terms of the hire purchase agreements in that case, and in particular whether the option price was purely nominal, as in the present case.

29. In any event, I do not disagree that for certain purposes the hire-purchase lessor of such goods would, under English law, be treated as the owner of them.⁹ However, it is certainly not correct that English would never allow the leases to be recharacterized. As I have explained above, whether an English court would do that would depend on the question being asked, and why.

30. I note that the Dismissal Order cites (at page 19) the textbook *Goode and Gullifer on Legal Problems of Credit and Security* as saying that English law “*sharply distinguishes the grant of security from the retention of title under conditional sale, hire purchase and leasing agreements, on the basis that the buyer, hirer, or lessee has merely a possessory interest, subject to which the seller, owner or lessor continues to enjoy absolute ownership by virtue of the agreement between the parties*”.

31. However, the very same passage (paragraph 1-04) goes onto to note that, although English law generally takes a formal approach,

⁹ In fact, under English law, the lessor would not have a conversion claim even if labelled “the owner”. Having leased the goods, the owner does not have an immediate right to possession, which is a precondition to a claim for conversion. It would only have a claim for damage to its reversionary interest as owner. This serves to demonstrate the point I made in paragraphs 15-16 above: that the focus must always be on the context of the recharacterization question.

“...this does not mean that English law always looks to the form of a transaction and not to the substance...if the document is a true record of the agreement but its terms indicate that its legal character is not that ascribed to the parties – as where a transaction described as a lease is in fact a conditional sale – the courts will disregard the label attached by the parties and look at the legal substance”.

32. That is the same point I have made above. If the context demanded it then there would be no obstacle to an English court recharacterizing an agreement labelled a “lease” as a finance lease – indeed that is precisely what happened in the recent School Facility Management case cited above.

The leases in the present case

33. As the cases set out above show, the precise factors on which a reclassification turns depend on the legal context and there is no direct equivalent to UCC 1-203(a) or California Commercial Code 1203(a) in English law.

34. However I have no real doubt that the English courts would, if asked to do so, be prepared to characterise the Aircraft Lease Agreements as finance leases in light of the cases set out above and the features of each contract set out below.

Plane 2 and Plane 3 ALA

35. [REDACTED]

36. [REDACTED]

10 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Plane 4 ALA

[REDACTED]

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Conclusions

43. English law recognises the distinction between “true” or operating leases on the one hand and finance leases on the other.
44. The English court would not decline to consider the particular features of the Aircraft Lease Agreements, including their economic effect, in order to determine whether they are operating leases or finance leases. In an appropriate case, the court will recharacterise a transaction described as an “operating lease” as a finance lease or a form of disguised borrowing, and would recognise a lessee’s proprietary interest in an arrangement such as the present one involving an option to purchase at the end of the term.
45. The English court would, if asked to do so, likely characterise the Aircraft Lease Agreements as finance leases rather than operating leases.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on 6 October 2021.



ROSALIND PHELPS QC

Fountain Court Chambers
Temple
London EC4Y 9DH

6 October 2021

ANNEXE 1

Rosalind Phelps QC was called to the Bar in 1998, after obtaining a first class BA degree in Law and French Law at the University of Oxford, followed by a distinction on the BCL (Bachelor of Civil Laws) postgraduate course at the University of Oxford. She was appointed Queen's Counsel in 2016.

Rosalind has practised as a barrister since 1999 at Fountain Court Chambers in London, a set of Chambers ranked by the Legal 500 as 'tier 1' for Banking and Finance and currently described by them as "*the pre-eminent set for financial disputes*". She specialises in disputes concerning banking and finance, and has been recommended by both the Legal 500 and Chambers & Partners in this field. Fountain Court is also banded in tier 1 by both directories for aviation. Rosalind is described by the Aviation editors of the Legal 500 2022 as "*a clear thinker with a profound understanding of the industry.*"

Examples of relevant recent experience include:

- *FSHC Group Holdings v GLAS* [2020] 2 WLR 429: For the Claimant (part of the Terra Firma group), in the trial of a claim for rectification in relation to structured finance documentation, and the appeal from that decision. Now the leading recent case on rectification of commercial contracts.
- Rosalind is frequently instructed by the UK's Civil Aviation Authority in relation to a range of issues. See for example *Re Flybe Limited*: appointed legal advisor to the CAA Panel issuing decision about Flybe's operating licence, culminating in the written decision in April 2020 (see [here](#)). Upheld on appeal to the Secretary of State for Transport (see [here](#)).
- *Alpstream AG v PK Airfinance and GE Capital Aviation Services* [2013] EWHC 2370; [2015] EWCA Civ 1318. Acted (with Stephen Moriarty QC) in the trial and appeal of a major Commercial Court action and appeal to the Court of Appeal brought in relation to aviation financing transaction. A leading authority on mortgagee's duties in relation to aircraft under English law.

**INDEX OF SOURCES CITED IN
OPINION OF ROSALIND PHELPS QC**

1. Re Atlantic Computer Systems Plc [1992] 2 WLR 367
2. Bank of Tokyo Ltd v Karoon (1984) [1987] AC 45
3. Bristol Airport Plc v Powdrill [1990] Ch 744
4. Re Brumark Investments Ltd: Agnew v Comm’r of Inland Revenue [2001] UKPC 28
5. Celestial Aviation Trading 71 Ltd v Paramount Airways Private Ltd [2010] EWHC 185
Comm.
6. On Demand Information PLC v Michael Gerson (Finance PLC) [2001] WLR 155
7. Orion Finance Ltd v Crown Financial Management Ltd [1996] BCC 621
8. School Facility Management v Governing Body of Christ the King College [2020]
EWHC 1118 (Comm)
9. In re Spectrum Plus Ltd (in liquidation) [2005] 2 AC
10. Street v Mountford [1985] AC 809
11. Goode and Gullifer on Legal Problems of Credit and Security (6th ed. 2017)

Exhibit 1

*505 In Re Atlantic Computer Systems Plc.



Positive/Neutral Judicial Consideration

Court

Court of Appeal (Civil Division)

Judgment Date

25 July 1990

Report Citation

[1992] 2 W.L.R. 367

[1992] Ch. 505



Court of Appeal

Neill, Nicholls and Staughton L.JJ.

1990 June 25, 26, 27, 28; July 2, 3, 4; 25

Insolvency—Administration order—Steps to enforce security—Insolvent company operating under administration order—Company subletting equipment held on lease or hire—purchase—Benefit of subleases assigned to owners by way of charge—Owners claiming rent and hire—purchase instalments—Whether recoverable as administration expenses—Owners seeking repossession and enforcement of security—Whether leave required—Whether equipment "in . . . company's possession"—Insolvency Act 1986 (c. 45), s. 11(3)

A company acquired computer equipment on lease or hire-purchase from funders for subletting to end users. The company assigned by way of charge to some of the funders the benefit of the subleases. The company ceased to be able to pay its debts and an administration order was made under [section 8\(3\)\(d\) of the Insolvency Act 1986](#) specifying as its purpose a more advantageous realisation of the company's assets than would be effected on a winding up. Thereafter, by virtue of [section 11\(3\)](#) of the Act of 1986,¹ the consent of the administrators or leave of the court was required before steps could be taken to enforce any security over the company's property or to repossess goods in the company's possession under any hire-purchase agreement. The administrators informed end users that payments due under the subleases should continue to be made to the company and substantial payments were received by the administrators. At the time of the administration order considerable sums of money were due from the company to the funders in respect of the headleases and hire-purchase agreements: after the order no payments were made by the administrators to the funders. The funders applied to the Companies Court for directions and other relief in the administration of the company. The judge held, inter alia, that they were entitled to receive sums due from the company under the headleases as expenses of the administration in respect of equipment used in the company's business during the administration; that the equipment was not in the company's possession for the purposes of [section 11\(3\)\(c\)](#) of the Act of 1986 and therefore no leave was required to obtain possession of it; but that no order should be made under [section 27](#) of the Act of 1986 on application of certain of the funders for discharge of the administration order or the granting of other relief.

On appeal by the administrators and cross-appeal by the funders: -

Held:

(1) allowing the appeal in part, that an administration was intended only as an interim and temporary regime allowing the administrators to seek to achieve one or more of the purposes set out in [section 8\(3\) of the Insolvency Act 1986](#) , and the question whether the owners of property being used by the *506 company during the interim period should be permitted to enforce their proprietary rights forthwith or should be paid in priority to other creditors depended on the circumstances in each case; that there was no justification for reading into the Act an implication that the owner of property suffering loss by reason of the restrictions on enforcement and repossession imposed by [section 11](#) should have some other remedy to compensate for such loss; and that, accordingly, the funders were not entitled as of right to be paid, as expenses of the administration, the rents and other outgoings due to them under the headleases and hire-purchase agreements; that the equipment, although largely under the immediate physical control of the end users, remained, as between the funders and the company, "in the company's possession" for the purposes of [section 11\(3\)\(c\) of the Act](#) and, in the absence of consent by the administrators, the leave of the court was required to take steps to terminate the headleases and hire-purchase agreements, to repossess the equipment or to enforce any security in relation to it (post, pp. 528A-B, C, 530E, H-531B, 532A-B, C-D).(2) Allowing the cross-appeal in part, that the assignment by the company to some of the funders of the benefit of the subleases by way of charge, being confined to rights to which the company was entitled under specific, existing contracts, created charges which were not of an ambulatory nature and could not therefore amount to floating charges; that, having regard to all the circumstances, the court would exercise its discretion under [section 11](#) to grant leave to take steps to terminate the headleases and to repossess the goods and, in the case of chargee funders, to enforce the security, and would direct the administrators to pay to the funders all sums received by the administrators since their appointment in respect of equipment belonging to the funders, together with interest, up to the amount of the arrears due under the respective head- leases and hire-purchase agreements at the time of payment to the administrators; and that, accordingly, there was no case for acceding to the petition under [section 27](#) of the Act to discharge the administration order (post, pp. 534B-C, 539E, 540G-H, 541E-F).

Dicta of Romer L.J. in *In re Yorkshire Woolcombers Association Ltd.* [1903] 2 Ch. 284 , 295, C.A. and of the Earl of Halsbury L.C. and of Lord Macnaghten in *Illingworth v. Houldsworth* [1904] A.C. 355 , 357, 358, H.L.(E.) applied.

Decision of Ferris J. reversed in part.

The following cases are referred to in the judgment of the court:

Bristol Airport Plc. v. Powdrill [1990] Ch. 744; [1990] 2 W.L.R. 1362; [1990] 2 All E.R. 493, C.A. .
Brown, Bayley & Dixon, In re, Ex parte Roberts and Wright (1881) 18 Ch.D. 649
Central Control Board (Liquor Traffic) v. Cannon Brewery Co. Ltd. [1919] A.C. 744, H.L.(E.) .
Downer Enterprises Ltd., In re [1974] 1 W.L.R. 1460; [1974] 2 All E.R. 1074
Higginshaw Mills and Spinning Co., In re [1896] 2 Ch. 544, C.A. .
Illingworth v. Houldsworth [1904] A.C. 355, H.L.(E.) .
International Marine Hydropathic Co., In re (1884) 28 Ch.D. 470, C.A. . *507
Lancashire Cotton Spinning Co., In re, Ex parte Carnelley (1887) 35 Ch.D. 656, C.A. .
Lloyd (David) & Co., In re (1877) 6 Ch.D. 339, C.A. .
Lundy Granite Co., In re, Ex parte Heaven (1871) L.R. 6 Ch.App. 462
National Arms and Ammunition Co., In re (1885) 28 Ch.D. 474, C.A. .
Nicoll v. Cutts [1985] B.C.L.C. 322, C.A. .
Oak Pits Colliery Co., In re (1882) 21 Ch.D. 322, C.A. .
Royal Trust Bank v. Buchler [1989] B.C.L.C. 130
Science Research Council v. Nassé [1980] A.C. 1028; [1979] 3 W.L.R. 762; [1979] I.C.R. 921; [1979] 3 All E.R. 673, H.L.(E.) .
Towers & Co. Ltd. v. Gray [1961] 2 Q.B. 351; [1961] 2 W.L.R. 553; [1961] 2 All E.R. 68, D.C. .
Traders' North Staffordshire Carrying Co., In re, Ex parte North Staffordshire Railway Co. (1874) L.R. 19 Eq. 60
Yorkshire Woolcombers Association Ltd., In re [1903] 2 Ch. 284, C.A. .

The following additional cases were cited in argument:

A.B.C. Coupler & Engineering Co. Ltd. (No. 3), In re [1970] 1 W.L.R. 702; [1970] 1 All E.R. 650
Anglo-Moravian Hungarian Junction Railway Co., In re, Ex parte Watkin (1875) 1 Ch.D. 130, C.A. .
Astor Chemicals Ltd. v. Synthetic Technology Ltd. [1990] B.C.L.C. 1

Beni-Felkai Mining Co. Ltd., In re [1934] Ch. 406
Brightlife Ltd., In re [1987] Ch. 200; [1987] 2 W.L.R. 197; [1986] 3 All E.R. 673
Charnley Davies Ltd. (No. 2), In re [1990] B.C.L.C. 760
China Pacific S.A. v. Food Corporation of India [1982] A.C. 939; [1981] 3 W.L.R. 860; [1981] 3 All E.R. 688, H.L.(E.) .
Clark (A Bankrupt), In re, Ex parte The Trustee v. Texaco Ltd. [1975] 1 W.L.R. 559; [1975] 1 All E.R. 453
Clough Mill Ltd. v. Martin [1985] 1 W.L.R. 111; [1984] 3 All E.R. 982, C.A. .
Four Point Garage Ltd. v. Carter [1985] 3 All E.R. 12
Great Eastern Electric Co. Ltd., In re [1941] Ch. 241; [1941] 1 All E.R. 409
H.H. Realisations Ltd., In re (1975) 31 P. & C.R. 249
James, Ex parte, In re Condon (1874) L.R. 9 Ch.App. 609
Johnson (B.) & Co. (Builders) Ltd., In re [1955] Ch. 634; [1955] 3 W.L.R. 269; [1955] 2 All E.R. 775, C.A. .
Levi & Co. Ltd., In re [1919] 1 Ch. 416
Liverpool Corporation v. Hope [1938] 1 K.B. 751; [1938] 1 All E.R. 492, C.A. .
London United Breweries Ltd., In re [1907] 2 Ch. 511
Mesco Properties Ltd., In re [1980] 1 W.L.R. 96; [1980] 1 All E.R. 117, C.A. .
Morris v. C. W. Martin & Sons Ltd. [1966] 1 Q.B. 716; [1965] 3 W.L.R. 276; [1965] 2 All E.R. 725, C.A. .
Ratford v. Northavon District Council [1987] Q.B. 357; [1986] 3 W.L.R. 771; [1986] 3 All E.R. 193, C.A. .
Rowbotham Baxter Ltd., In re [1990] B.C.L.C. 397
St. Ives Windings Ltd., In re (1987) 3 B.C.C. 634
Tatung (U.K.) Ltd. v. Galex Telesure Ltd. (1988) 5 B.C.C. 325
Tyler, In re, Ex parte Official Receiver [1907] 1 K.B. 865, C.A. .
Willment (John) (Ashford) Ltd., In re [1980] 1 W.L.R. 73; [1979] 2 All E.R. 615 *508

The following cases, although not cited, were referred to in the skeleton arguments:

Attorney-General v. Birmingham, Tame and Rea District Drainage Board [1912] A.C. 788, H.L.(E.) .
Aveling Barford Ltd., In re [1989] 1 W.L.R. 360; [1988] 3 All E.R. 1019
Bacon (M.C.) Ltd., In re [1991] Ch. 127; [1990] 3 W.L.R. 646
Cloverbay Ltd. (No. 2), In re [1990] B.C.C. 229
Colonial Sugar Refining Co. Ltd. v. Melbourne Harbour Trust Commissioners [1927] A.C. 343, P.C. .
Company (No. 00175 of 1987), In re A [1987] B.C.L.C. 467
Gomba Holdings U.K. Ltd. v. Minorities Finance Ltd. [1988] 1 W.L.R. 1231; [1989] 1 All E.R. 261, C.A. .
Hill (Edwin) and Partners v. First National Finance Corporation Plc. [1989] 1 W.L.R. 225; [1988] 3 All E.R. 801, C.A. .
Oriental Credit Ltd., In re [1988] Ch. 204; [1988] 2 W.L.R. 172; [1988] 1 All E.R. 892
Smith (A Bankrupt), In re, Ex parte Braintree District Council [1990] 2 A.C. 215; [1989] 3 W.L.R. 1317; [1989] 3 All E.R. 897, H.L.(E.) .
Westminster Bank Ltd. v. Beverley Borough Council [1971] A.C. 508; [1970] 2 W.L.R. 645; [1970] 1 All E.R. 734, H.L.(E.) .

APPEAL and CROSS-APPEALS from Ferris J.

On 18 April 1990 an administration order was made in respect of Atlantic Computer Systems Plc. under section 8 of the Insolvency Act 1986 and Mr. J.F. Soden and Mr. R.C. Boys-Stones were appointed administrators of the company. By applications dated 17 May 1990 two groups of creditors of the company which had leased equipment to it, (1) the Allied Irish Banks group ("A.I.B."), consisting of A.I.B. Capital Markets Plc. and Allied Irish Banks Plc., and (2) the Norwich Union Group ("Norwich"), consisting of Norwich Union Insurance Group (Equipment Leasing) Ltd., Norwich Union Equipment Finance Ltd., Eastlease Ltd., Norwich Union Leasing Ltd. and Norwich Union Finance (No. 3) Ltd., sought from the Companies Court of the Chancery Division directions and other relief in the administration. By a petition of the same date Norwich prayed for an order under section 27 of the Act of 1986 to discharge the administration order. On 25 May Ferris J. made an order that (1) the applicants were entitled to receive sums due from the company under the leases as expenses of the administration in respect of equipment used in the company's business during the administration; (2) the equipment was not in the company's possession for the purposes of section 11(3)(c) of the Act of 1986; and (3) no order should be made under section 27 of the Act in favour of Norwich on their application for discharge of the administration order or the granting of other relief. On 22 June the judge made additional directions pursuant to applications by the administrators.

By notice of appeal dated 5 June 1990 the company and the administrators appealed against the judge's order on the grounds, inter alia, that the judge had erred in law in (1) holding that if chattels owned by a third party were made available to a company in respect of which an administration order was in force, pursuant to a contract entered into prior to the making of such order, and

were used by the administrators or the company in the course of its business or for its benefit, the owner *509 of such chattels was entitled to receive, as an expense of the administration, the payments provided for under such contract which accrued due in the period during which the administration order was in force; (2) failing to hold that the liability to make such payments pursuant to such contracts ranked only (save only where such liability was otherwise secured) as an unsecured liability of the company in administration, the enforcement of which was subject to the provisions of section 11(3) of the Act; and (3) holding that where any such computer equipment was in the physical possession of the sublessee, such equipment was not, as between the company and the owner, in the possession of the company within the meaning and for the purposes of section 11(3) of the Act.

By a respondent's notice by way of cross-appeal A.I.B. cross-appealed against so much of the judgment as held that (a) leave was required under section 11(3)(c) for A.I.B. both to perfect and to enforce their security; and (b) as a matter of discretion, the judge should refuse to give such leave on the grounds, inter alia, that (1) the section 11 restrictions on enforcement by creditors of their rights were intended to affect the rights of creditors in respect of debts which had arisen before and not after the date of the administration order; (2) if A.I.B. were not to be paid either when sums became due to them or at all, they should be given leave to enforce their security; (3) the "limited recourse" nature of the A.I.B. assignments of the benefit of the end user leases and the payments due thereunder meant that (prior to the assignment becoming enforceable) such assignments were absolute and not by way of mortgage, charge or other security; and (4) A.I.B. were entitled to be paid the end users' rentals as moneys had and received by the company (by its administrators) to the use of A.I.B., or might be traced in equity.

By a respondent's notice by way of cross-appeal dated 21 June 1990 Norwich sought, inter alia, an order that if and to the extent that any goods and equipment the subject of any lease or lease purchase agreement between Norwich and the company were in the possession of the company within the meaning of section 11(3) of the Act of 1986, there be leave thereunder to Norwich to take any step to exercise any contractual right to terminate the lease or lease purchase agreement, and thereafter to exercise any rights which Norwich might have to recover rent and other payments from, and enforce any obligation against, any sublessee or other user of the goods and equipment the subject of such lease or lease purchase agreement or to recover the goods and equipment, on the grounds that (1) the judge had expressed the view that, if he had not decided that Norwich were entitled to payment of the administration period indebtedness under such lease and lease purchase agreements, alternatively had not made the decision referred to in ground (1) of the administrators' notice of appeal, the case for granting such leave under section 11(3) of the Act to Norwich would have been very strong: such view being correct, if the administrators' appeal against those decisions were to succeed, such leave ought to be given; and (2) in any case, if on a true understanding of the judgment administration period indebtedness did not extend to all *510 liabilities and obligations under such lease and lease purchase agreements, the judge had erred in law in declining to give such leave.

The facts are set out in the judgment of the court.

APPEAL

Philip Heslop Q.C., Gabriel Moss Q.C., Victor Joffe and Robert Miles for the company and its administrators. The rentals due from the company under the hire-purchase agreements and headleases are not recoverable as part of the expenses of the administration: the funders must either (a) seek leave to proceed against the company under section 11 of the Insolvency Act 1986 or (b) petition under section 27 of the Act on the ground of unfair prejudice. A distinction must be drawn between leases and subleases of land on the one hand, and of chattels on the other. In the case of a lease of land to a company and a sublease from the company, termination of the company's interest would automatically terminate the sublease. By contrast, a lease and sublease of chattels merely set up two contractual relationships, which can either continue or terminate independently of each other. Thus the termination of the headlease does not terminate the contract between the company and the end user. Since the chattels were let with the consent of the funder, the latter has no right to repossession as against the end user, there being no privity of contract between them. The judge was wrong to import liquidation principles relating to land into an administration.

A prudent headlessor can protect himself where a sublease is contemplated by registering a charge over the sub-rentals. Where an administration order has been made the headlessor will need the leave of the court under section 11(3)(c) of the Act to enforce his security. He bears the onus of showing that the statutory discretion should be exercised in his favour, and in exercising its discretion the court must undertake a balancing exercise by weighing up the competing interests of secured and unsecured creditors: *Royal Trust Bank v. Buchler* [1989] B.C.L.C. 130. The funders cannot rely on any concept of entitlement absolving them from the obligation to seek leave to enforce their rights under section 11.

The new regime of administration orders was introduced by the Insolvency Acts 1985 and 1986 to plug any gap where the business of an insolvent company could be beneficially carried on but the appointment of a receiver out of court was not possible:

see the Cork Committee's Report on Insolvency Law and Practice (1982) (Cmnd. 8558). Under the new regime administrators have powers roughly identical to those conferred on administrative receivers: see [sections 14 and 42 of, and Schedule 1 to, the Act of 1986](#). Administrations are to be regarded as transient regimes which will ultimately give way either to a winding up or to a resumption of business. There are severe restrictions on all creditors, most strikingly on secured creditors.

There is a fundamental difference between the roles of the liquidator and the administrator in administering an insolvent estate. Unlike the liquidator, the administrator has no power to pay off classes of creditors: *In re St. Ives Windings Ltd. (1987) 3 B.C.C. 634*. Although an administrator may in certain circumstances choose to pay a debt and [*511](#) charge it to expenses, it is very unusual for him to pay a pre-administration debt. A distinction has to be drawn, in any event, between a power to pay a debt and an obligation to do so. The provisions of the Act of 1986 relating to administration orders should be construed in accordance with the approach adopted in *Bristol Airport Plc. v. Powdrill [1990] Ch. 744*.

As to whether, prior to the Act, there was a general principle whereby certain of a company's obligations were treated as expenses of the insolvency regime having priority over pre-regime creditors, *In re John Willment (Ashford) Ltd. [1980] 1 W.L.R. 73* was the only case referred to by the judge which involved a receiver appointed out of court. It does not support the proposition that entitlement to pre-preferential payments out of assets in an insolvent administration should apply in the case of administration orders. [Reference was made to *Liverpool Corporation v. Hope [1938] 1 K.B. 751*.] There is no principle of enforceable pre-preferentiality to be obtained under the heading of receivership costs in the case of receivers appointed out of court: *Nicoll v. Cutts [1985] B.C.L.C. 322*. The same applies to companies in administration.

Under [section 44\(1\)\(b\)](#) of the Act an administrative receiver has 14 days' breathing space from his appointment before he can be taken to have adopted a pre-regime contract of employment. Apart from that statutory exception the receiver does not become liable on contracts entered into by the company prior to his appointment. The same principle should apply to an administrator. The other contracting party is not left without a remedy: he can prove in any subsequent liquidation. As to items chargeable as expenses of an out-of-court receivership, see *Ratford v. Northavon District Council [1987] Q.B. 357* and *Tatung (U.K.) Ltd. v. Galex Telesure Ltd. (1988) 5 B.C.C. 325*.

There is a clear parallel in the Act between the position of administrative receivers and administrators: cf. [section 44\(1\)\(b\) and \(c\) and section 19\(4\) and \(5\)](#). These parallel provisions show that, if anything, an administrator is treated more favourably than an administrative receiver. That suggests strongly that administrators should be in no worse position in relation to pre-administration contracts than are administrative receivers in relation to pre-receivership contracts. Accordingly, where a post-administration liability arises in respect of a pre-administration contract, such liability should not have the status of an expense of the administration, any more than such a liability arising after the commencement of a receivership would qualify as a receivership expense.

The judge erred in his formulation of the pre-preferentiality rule. The cases on which he relied refer only to (a) the contracting by the liquidator of new liabilities; and (b) the use and occupation of land: see *In re Oak Pits Colliery Co. (1882) 21 Ch.D. 322*. There is no such general principle applicable to the use of hired chattels: see *In re A.B.C. Coupler & Engineering Co. Ltd. (No. 3) [1970] 1 W.L.R. 702*; *In re Beni-Felkai Mining Co. Ltd. [1934] Ch. 406*; *In re Great Eastern Electric Co. Ltd. [1941] Ch. 241*; *In re H.H. Realisations Ltd. (1975) 31 P. & C.R. 249*; *In re International Marine Hydropathic Co. (1884) 28 Ch.D. 470*; *In re Levi & Co. Ltd. [1919] 1 Ch. 416*; *In re London United Breweries Ltd. [1907] 2 Ch. 511*; *In re Mesco Properties Ltd. [1980] 1 W.L.R. 96* and *In re National Arms and Ammunition Co. (1885) 28 Ch.D. 474*. The principle of payment of rentals as an expense of the insolvency regime applies only (a) in liquidations and (b) to leases of land. There is no entitlement to be paid in respect of such use. The court has a discretion whether to allow such liabilities to be paid in full: *In re Downer Enterprises Ltd. [1974] 1 W.L.R. 1460*.

Liability arising by reason of possession of land by a liquidator becomes a pre-preferential claim only if and when the liquidator's possession can be said to be for the benefit of the winding up. That presupposes that the liquidator has an election whether or not to take or retain possession for the purposes of the winding up and the test is satisfied only if there is a finding that the choice has been made: *In re A.B.C. Coupler & Engineering Co. Ltd. (No. 3) [1970] 1 W.L.R. 702*. It is for the claimant to show that the liquidator has elected to remain in possession for the purposes of the winding up. Thus the judge erred in imposing on the administrators an onus to show that in respect of any particular case they were not making use of the funders' chattels.

Since the pre-administration subleases were made with the knowledge of the funders, who consented to the receipt of the subrental moneys by the company, the company, by requiring and receiving those payments, was not "using" the funders' property. Alternatively, as the "use" was with the funders' consent, their only remedy is contractual. The effect of the judge's

decision is (a) to convert the wholly unsecured funders into secured creditors in respect of post-administration expenditure; and (b) to give secured funders automatic rights against the administrators, thus by-passing the safeguard provided by section 11.

Sections 10, 11 and 15 of the Act in combination equate the chattel owner under a hire-purchase agreement with a secured creditor. Since the policy of the statute is to oblige chattel owners to seek the consent of the administrator or the leave of the court before enforcing their rights, it would be wrong to apply to administrators a principle borrowed from liquidation which would dispense with the need for such consent or leave.

The statutory objective of sections 10, 11 and 15 can be achieved only by giving the word "possession" in the Act a suitably wide meaning so as to include chattels sublet by the company to end users: if the words "goods in the company's possession" in section 11(3)(c) were to be construed narrowly as requiring physical custody that statutory objective would be largely frustrated. The intention of the legislation was to regulate the position of the owners vis-à-vis the hire-purchasers (the company): see *Four Point Garage Ltd. v. Carter* [1985] 3 All E.R. 12 .

Michael Crystal Q.C. and Richard Adkins and Michael Crystal Q.C., David Mabb and Mark Phillips for, respectively, A.I.B. and Norwich. If an administrator causes the company to use something, that use has to be paid for, whether it be use of goods or services or use which gives rise to central or local government taxes. A determination that no obligation exists to pay rent or other expenses during the administration would amount to expropriation without compensation, an intention not *513 to be imputed to Parliament unless expressed in unequivocal terms: *Central Control Board (Liquor Traffic) v. Cannon Brewery Co. Ltd.* [1919] A.C. 744 .

The only power of expropriation in the Act of 1986 is one of outright disposal, carrying with it a right to compensation: section 15 deals with the circumstances in which an administrator may *dispose of* property the subject of "hire-purchase agreements" (and the financial consequences thereof for the company) and sets out the power of the administrator to dispose of the company's property which is subject to security, but the latter power relates only to floating charges. Neither can apply to A.I.B.'s or Norwich's interest in the equipment or A.I.B.'s interest in the end user leases or the rentals. Part II of the Act strikes a delicate balance between the interests of the company in administration and other parties, e.g. owners of property in the company's possession. That balance should not be disturbed.

The wide functions and powers of an administrator are to be contrasted with those of a receiver, whose primary duty prior to the Act of 1986 was to realise the company's assets in the interests of the debenture holder by whom he was appointed: *In re B. Johnson & Co. (Builders) Ltd.* [1955] Ch. 634 . There is no indication in the Act that a radical change in the nature of the receiver's duties was intended and an administrative receiver appointed under the Act owes no duty to act in the best interests of the company's unsecured creditors. Thus it is wholly inappropriate to assimilate receivership with the mainstream of insolvency procedures, which are concerned with the interests of the unsecured creditors of the company.

The case law during the century prior to the Act, in relation to all forms of winding up, court-appointed and out of court receiverships, supports the proposition that all expenses arising in an insolvency administration must be paid as an expense of that administration. If in the course of a corporate insolvency the liquidator uses property belonging to a third party for the benefit of the corporation, the proper price for that use is to be treated as an expense of the winding up or receivership. The courts in the 1880s were not developing a new principle of company liquidation, but were following established principles governing insolvency of partnerships and the administration of deceased persons' estates. *In re Beni-Felkai Mining Co. Ltd.* [1934] Ch. 406 ; *In re Great Eastern Electric Co. Ltd.* [1941] Ch. 241 ; *In re International Marine Hydropathic Co.*, 28 Ch.D. 470 ; *In re Levi & Co. Ltd.* [1919] 1 Ch. 416 ; *In re London United Breweries Ltd.* [1907] 2 Ch. 511 and *In re National Arms and Ammunition Co.*, 28 Ch.D. 474 represent a constant stream of authority supporting the propositions for which the judge relied on them. [Reference was also made to *Astor Chemicals Ltd. v. Synthetic Technology Ltd.* [1990] B.C.L.C. 1 ; *In re A.B.C. Coupler & Engineering Co. Ltd. (No. 3)* [1970] 1 W.L.R. 702 and *In re Downer Enterprises Ltd.* [1974] 1 W.L.R. 1460 .

Parliament must have intended that in an administration the economic risk should be borne by the creditors and members of the company rather than by the owner of goods in its possession. In general, there must be a real prospect that one or more of the statutory purposes of *514 the administration order set out in section 8(1)(b) will be achieved: *In re Rowbotham Baxter Ltd.* [1990] B.C.L.C. 397 . In *Bristol Airport Plc. v. Powdrill* [1990] Ch. 744 there was a funding arrangement for the payment of the airport charges from the outset of the administration, and the court was not faced with the instant situation. In *In re Charnley Davies Ltd. (No. 2)* [1990] B.C.L.C. 760 the importance of a funding arrangement was stressed.

The "estate" of a company in administration must ultimately bear the post-administration debts and liabilities of the administration. Such debts and liabilities may be discharged by the administrator as and when they fall due for payment or discharge. If not, the court will declare that the administrator should discharge such debts and liabilities out of the assets of the company. While the relevant post-administration creditors have no direct claim against the administrator, (a) the administrator may be liable to the company for breach of a duty owed to it; (b) the company remains liable to discharge the debts and liabilities both pre- and post-administration, although enforcement is only possible with the administrator's consent or the leave of the court. Leave to enforce: (i) will not be given in respect of pre-administration debts or liabilities; (ii) will be given if the administrator (it having been declared that he should cause the company to discharge its debts and liabilities) either (a) cannot discharge them because of the insolvency of the estate, or (b) can, but does not, discharge them.

Under the principle in *Ex parte James, In re Condon (1874) L.R. 9 Ch.App. 609* the court has an inherent discretion to deny its officer rights and remedies to which he is on the face of it entitled by law, where the exercise of those rights or remedies would, in the opinion of the court, be unfair or inequitable. If it would be "shabby" (see *In re Tyler, Ex parte Official Receiver [1907] 1 K.B. 865*) not to pay the owners' expenses, the court can direct the administrator to do so. *Nicoll v. Cutts [1985] B.C.L.C. 322* is distinguishable since there the court was concerned with a priority contest between a debenture holder and an unsecured creditor; moreover, it was clear on the facts that there was no use by the receiver of the employee's services. [Reference was also made to *Liverpool Corporation v. Hope [1938] 1 K.B. 751* .]

If an administrator decides to make use of the company's interest in a chattel owned by another for the purposes of his administration, he is obliged to satisfy the company's commitments to the owner of the chattel during the period of the administration. If he requires a period of time in which to decide whether or not to make use of the chattel interest he should notify the owner of the position as soon as reasonably practicable after the commencement of the administration and state whether or not he is prepared to be responsible for the company's commitments to the owner arising between the date of the administration order and the date of notification of his decision to the owner. So, even if the funders' right to be paid the sums due under the headleases from the date of the administration order was not absolute, that right accrued after a reasonable time had elapsed within which the administrators could make up their minds whether they wished to retain the headleases. The administrators clearly used the computer equipment for the benefit *515 of the insolvent estate in the course of carrying on the company's business and with a view to realisation of the company's lease portfolio.

There being no definition of "possession" in the Act of 1986, the construction of that term will depend on the circumstances of each case: see *Towers & Co. Ltd. v. Gray [1961] 2 Q.B. 351* .

The important feature of a bailment is the transfer of possession of the chattel to the bailee. A bailee who sub-bails with authority creates a bailment between the owner and the sub-bailee. Here, the end user was in physical possession of the computer equipment on its own behalf and for its own purposes, and as a bailee of the company. Provided the end user complied with the terms of the sublease the company had no right to interfere with the end user's possession. Accordingly the company was neither in physical possession of the goods, nor did it have an immediate right to possession. "Use" of the computer equipment was not synonymous with possession, since the company in administration was using its rights under the lease and hire-purchase agreements but was not using the equipment itself. Suppose O bails to X, who sub-bails to Y, who sub-bails to Z. Suppose, further, that X goes into administration and that Y, for reasons unconnected with that, seeks repossession from Z. If the construction of "possession" canvassed by the administrators is correct, Y would need the consent of X's administrator or leave of the court. [Reference was made to *Morris v. C. W. Martin & Sons Ltd. [1966] 1 Q.B. 716* ; *China Pacific S.A. v. Food Corporation of India [1982] A.C. 939* and *Clough Mill Ltd. v. Martin [1985] 1 W.L.R. 111* .]

Heslop Q.C. in reply. The funders' proposition that the estate of a company in administration must ultimately bear the post-administration debts and liabilities of the administration is too broadly stated. The proposition applies only to new contracts, employment contracts and contracts adopted by the administrator.

It is an essential feature of the funders' case that the position of an administrator is comparable to that of a liquidator. While in some respects the position of an administrator differs from that of an administrative receiver, on the issue of administration expenses their positions are identical and contrast with that of a liquidator.

Nicoll v. Cutts [1985] B.C.L.C. 322 is not confined to contracts of employment and the fact that the actual decision has been affected by subsequent legislation does not detract from the principle of the case, which is correct. The funders' submission that the case is one of non-use is not borne out by the facts.

[Section 19\(5\)](#) is confined to debts and liabilities incurred whilst in office and cannot extend to liabilities for pre-administration contracts, other than contracts of employment adopted by the administrator.

As to the argument that unless liquidation principles are imported into the administration regime hardship will be caused to owners of goods, any hardship will be alleviated by the ability to apply for leave under [section 11](#). In contrast, the judge's finding that the owners were automatically entitled to rentals as administration expenses allows no opportunity for the court to undertake a balancing exercise. In such circumstances there is a serious risk of running the administration at a *516 deficit. The procedure under which the administrator may give his consent under section 11 is designed to filter out cases which obviously merit the giving of consent, as distinct from cases where consent may interfere with the purpose of the administration. The concept of automatic entitlement to administration expenses could expropriate other creditors and would contradict the *pari passu* principle of distribution. A liquidator's status as an agent of the company (see *In re Anglo-Moravian Hungarian Junction Railway Co., Ex parte Watkin (1875) 1 Ch.D. 130*) is to be contrasted with that of a receiver appointed out of court: cf. [section 14\(5\)](#) of the Act, which stipulates that an administrator is an agent of the company.

In re Clark (A Bankrupt), Ex parte The Trustee v. Texaco Ltd. [1975] 1 W.L.R. 559 lays down four conditions for the application of the *Ex parte James, L.R. 9 Ch.App. 609* principle, none of which applies to the present case.

[Section 205\(1\)\(xix\) of the Law of Property Act 1925](#) illustrates the way in which "possession" may be given an extended meaning.

In the funders' hypothetical example of a bailment by X to Y and a sub-bailment by Y to Z, section 11 has no application to what Y may do as far as X is concerned because the section applies only to a contest between the *owner* and the person who has a right to possession.

[NICHOLLS L.J. It is the court's present view that rentals are not expenses of the administration and that the equipment remains in the company's possession for the purposes of section 11(3)(c). We therefore invite argument on the issue whether leave should be granted under section 11(3).]

CROSS-APPEAL

Michael Crystal Q.C. and Richard Adkins and Michael Crystal Q.C., David Mabb and Mark Phillips for, respectively, A.I.B. and Norwich. In exercising its discretion the court should ensure, as far as possible, that administration should not prejudice the rights of those who have rights to security or to repossess goods: see *Bristol Airport Plc. v. Powdrill [1990] Ch. 744*. The section 11 restrictions on enforcement by creditors of their rights are intended to affect the rights of creditors in respect of debts which have arisen before and not after the administration order. If the administration period indebtedness is not to be paid as an expense of the administration, the funders should be given leave to repossess the equipment since (a) they would otherwise be forced to allow their property to be used in the administration in order to produce a stream of income from end users which might be used for creditors generally; (b) their right to possession has not arisen as a result of any acts by the administrators; (c) they have not received any benefits from the administration; and (d) they have made their position clear and have not blown hot and cold.

A.I.B.'s application is two-fold: they are owners and secured creditors. If they are not to be paid either when sums become due to them or at all, they should be given leave to enforce their security.

Philip Heslop Q.C., Gabriel Moss Q.C., Victor Joffe and Robert Miles for the company and its administrators. According to *Royal Trust Bank v. Buchler [1989] B.C.L.C. 130* the onus is on the applicant seeking leave to show why leave should be granted and the court has a true discretion in the matter. As a matter of principle all the funders ought to be treated equally in the administration. The administrators do not claim that their views are conclusive but it is customary to give some weight to the opinions of office-holders.

If an owner agrees to give possession of his goods to another person for a particular period, but thereafter changes his mind, he can terminate the headlease but this will be subject to the sublessee's interest. Thus if leave were to be granted there would be no advantage to the funders if they could not proceed against the sublessees.

A.I.B.'s security over the benefit of the end users' subleases constituted floating and not fixed charges, the subrentals being future assets of the company: see *Illingworth v. Houldsworth [1904] A.C. 355*; *In re Brightlife Ltd. [1987] Ch. 200* and *In re*

Yorkshire Woolcombers Association Ltd. [1903] 2 Ch. 284 . Therefore leave should not be given, since that would enable A.I.B. to defeat a potential charge under section 19(4) and (5).

Crystal Q.C. in reply. Since the rights under the subleases assigned by the company to A.I.B. were rights under specific, existing contracts, the assignments did not create floating charges: see *Illingworth v. Houldsworth* and *In re Yorkshire Woolcombers Association Ltd.* It is hard to imagine a stronger case for granting leave than a situation where administrators are using property of a third party without paying for it. The only statement of principle to be extracted from *Royal Trust Bank v. Buchler* [1989] B.C.L.C. 130 is that an applicant for leave under section 11(3) must make out a case. If the leave issue is to be pivotal, the court should be wary of attaching any particular weight to the views of office-holders.

Cur. adv. vult.

25 July 1990. The following judgment of the court was handed down

NICHOLLS L.J.

This is the judgment of the court in a case which raises some important points concerning administrations under [Part II of the Insolvency Act 1986](#) . We shall need to add more detail at a later stage, but for the moment we can use a broad brush when setting out the essential facts. Atlantic Computer Systems Plc., to which we shall refer as "the company," is the major operating company in the United Kingdom of a large and complex group of companies, the "Atlantic group," with interests in computer leasing. There are about 120 companies in the group, of which the majority are active trading companies. We were told that this group is, or was, the third largest leasing business in the world.

The ultimate parent of all these companies is British & Commonwealth Holdings Plc. ("B. & C."). Earlier this year B. & C. stopped providing financial support for the Atlantic group. The company ceased to be able to pay its debts. On 18 April 1990 Hoffmann J. made an administration [*518](#) order in respect of the company, specifying purpose (d) in section 8(3) of the Act as the purpose which making an administration order would be likely to achieve, namely, a more advantageous realisation of the company's assets than would be effected on a winding up. Two partners in Price Waterhouse, Mr. J. F. Soden and Mr. R. C. Boys-Stones, were appointed joint administrators. The order was made on the application of Atlantic Computer Services Group Plc., which is the company's immediate parent, and which is itself a substantial creditor of the company.

The 2,500 existing leases granted by the company in respect of computers fall into several different categories. For present purposes we need refer to only two categories. In both these categories the capital cost of acquiring the computers was provided by a bank or other financial institution ("the funder"). In the first category, which comprises some 632 cases on the administrators' calculations, the computer is owned by the funder and let to the company under a hire-purchase agreement. The company in turn, and as was intended by the funder, then let the computer to the "end user" under a further lease ("the sublease"). In the second category, which comprises some 76 cases, the procedure was similar save that the arrangement between the funder and the company was a lease (a "headlease") as distinct from a hire-purchase agreement. For present purposes nothing turns on the distinction between these two categories. The fundamental feature, common to both categories, is that the computers are the property of the funder. In many instances in the first category, the hire-purchase agreement provided for the company to assign to the funder the stream of income to which the company was entitled under the sublease. But here also, for the purpose of the initial questions which arise for decision, nothing turns on the presence or absence of this additional feature. Among the funders in one or both of these two categories of transactions are companies in the groups headed respectively by Norwich Union Life Insurance Society and Allied Irish Banks Plc. We shall refer to the companies in these respective groups as "Norwich" and "A.I.B."

A few days after the administration order was made the administrators sent a circular to the end users notifying them of the administration order and telling them that payments due under the subleases should continue to be made to the company. Thereafter invoices were sent out periodically by the administrators. Substantial payments have been received by the administrators since 18 April. The money is set aside in designated bank accounts. Up to 8 June the administrators received from end users sums in excess of £1.7m. Approximately £220,000 of this was in respect of subleases of computers owned by Norwich, and about £7,000 in respect of subleases of computers owned by A.I.B. The income stream from end users has now substantially dried up. Most end users have stopped paying. Some of them have said they will not pay until the company confirms that it will meet all its obligations under the subleases.

As to the headleases (in which expression we include hire-purchase agreements between funders and the company), substantial payments have fallen due, and are continuing to fall due, from the company to the [*519](#) funders, including Norwich and

A.I.B. When the administration order was made the arrears owing to Norwich and A.I.B. were about £976,000 and £1,116,000 respectively. Over the three-month period from 18 April to 18 July the indebtedness accruing due to Norwich and A.I.B. respectively was about £1.1m. and £520,000. But since the date of the administration order no payments have been made by the administrators to Norwich or A.I.B., or to any other funders, in respect of headleases. and the administrators have declined to consent to Norwich and A.I.B. exercising their rights to terminate the headleases.

The first question: administration expenses

It is in these circumstances that the first question arises. The administrators have received and retained money payable under the subleases in respect of computer equipment which is the property of the funders. Are the administrators obliged, as Norwich and A.I.B. contend, to pay as expenses of the administration all the sums falling due under the headleases? Ferris J. upheld this contention. The core of his reasoning is to be found in the following passage in his judgment. Having considered certain authorities, he said:

"... I think that the principle comes to this. If in the course of a corporate insolvency the liquidator or receiver uses or realises property belonging to a third party for the benefit of the corporation, then the proper price for that use or realisation, and also any liabilities such as rates or taxes which arise from such use or realisation, are to be treated as an expense of the winding up or receivership and paid accordingly. Where the use or realisation is based upon a contractual right, the proper price is that provided for by the contract. I think that this principle is based not upon any provision of the legislative regime governing the winding up or receivership but upon the fact that this is an ordinary consequence of the use of property belonging to another, and that the legislation does nothing to relegate the claim for payment on the part of the owner of that property to that of an unsecured creditor whose debt became due before the insolvency. If this is right, as I think it is, it would be strange if a similar principle did not apply to administrations under Part II of the Act of 1986."

The appeal came on speedily, before the formal order embodying the judge's decision had been drawn up. We were shown a draft order, agreed by the parties, which contains declarations to the effect that the rentals and supplemental rentals accruing due under the headleases from the date of the administration order were payable as an expense of the administration. Likewise with insurance payments, contractual interest and damages payable for breach of covenant to insure or maintain the equipment. The joint administrators have appealed against that decision.

The issue raised by this part of the appeal calls for a consideration of the relevant provisions of the Act of 1986. However, we must deal first with two preliminary matters which formed the basis of much of the argument presented to us on the proper interpretation of the Act. *520

The use of property by a liquidator: the "liquidation expenses" principle

The first preliminary matter is to identify the principles to be distilled from the authorities relating to liquidation expenses on which the judge mainly relied. The relevant authorities go back over 100 years to the [Companies Act 1862 \(25 & 26 Vict. c. 89\)](#). That Act established company law in a form which has continued unchanged in its essence up to the present. The cases in question arose out of the provision in that Act, section 87, which was the distant predecessor of [section 130\(2\)](#) of the Act of 1986. Section 130(2) provides that when a winding up order has been made or a provisional liquidator appointed "no action or proceeding shall be proceeded with or commenced against the company or its property, except by leave of the court and subject to such terms as the court may impose." Over the years the courts have been concerned to establish the principles on which the discretion to give or refuse leave under that provision should be exercised. In doing so they have been guided, as one would expect, by the purpose for which Parliament imposed the prohibition. For present purposes it is sufficient to note two classes of actions or proceedings for which leave is sought, namely, (1) where a person seeks leave in a liquidation to possess or repossess what in law is his own property and (2) where a person seeks leave in a liquidation to exercise a remedy over the company's property. An example of the first category is where a mortgagee seeks possession of property mortgaged to him. An example of the second category is where a rating authority seeks leave to distrain for unpaid rates. In the case of a lessor of land let to a company, the appropriate category depends on the remedy the lessor is seeking to exercise in respect of the arrears of rent owing to him. If he is seeking to exercise a right of re-entry, he falls into the first category. If he is seeking leave to distrain, he falls into the second category.

A judicial exposition of the purpose for which the prohibition on commencing or pursuing proceedings was imposed, and how this affects actions in the first category, can be found in the judgment of James L.J. in *In re David Lloyd & Co. (1877) 6 Ch.D. 339*, 344-345:

"These sections in the Companies Act, and the corresponding legislation with regard to bankrupts, enabling the court to interfere with actions, were intended, not for the purpose of harassing, or impeding, or injuring third persons, but for the purpose of preserving the limited assets of the company or bankrupt in the best way for distribution among all the persons who have claims upon them. There being only a small fund or a limited fund to be divided among a great number of persons, it would be monstrous that one or more of them should be harassing the company with actions and incurring costs which would increase the claims against the company and diminish the assets which ought to be divided among all the creditors. But that has really nothing to do with the case of a man who for the present purpose is to be considered as entirely outside the company, who is merely seeking to enforce a claim, not against the company, but to his own property. The position of a mortgagee under such circumstances is, to my mind, exactly similar to that of a *521 man who said, 'You the company have got property which you have taken from me; you are in possession of my property by way of trespass, and I want to get it back again.' A landlord might say, 'You have property under lease from me; you have broken the covenants of the lease, and I have a right of re-entry in consequence of that breach.' The company ought not, because it has become insolvent or has been minded to wind up its affairs, to be placed in a better position than any other lessee with regard to his lessor. So with regard to a mortgagee. The mortgagee says, 'There is some property upon which I have a certain specific charge, and I want to realise that charge. I have nothing to do with the distribution of your property among your creditors, this is my property.' Why a mortgagee should be prevented from doing that I cannot understand. Power was given to the court to interfere with actions by restraining them or not allowing them to proceed, but this power was given because it was understood that the court would exercise it with a due regard to the rights of third persons, persons who were not members of the company, and who had not to come in and claim to share in the distribution of the company's assets among the creditors, and who were not therefore quasi parties to the winding up proceedings. The court would have due regard to the rights of independent persons. A mortgagee is, to my mind, such an independent person . . ."

Two points are to be noted regarding cases of this first type, which we can call "possession" cases: (1) in the absence of special circumstances, leave is given as of course, and (2) it is immaterial whether the arrears of rent under the lease, or the arrears of interest under the mortgage, accrued due before or after the commencement of the winding up. In this type of case the claimant is not seeking an order for payment, or seeking to enforce an order for payment, although his claim for possession may well have the indirect effect of compelling the company to pay.

In contrast is the second type of case, where a person seeks leave to seize the *company's* property. There, prima facie, to grant leave would be inconsistent with the purpose for which Parliament imposed the prohibition on proceedings. This is so whether the claim, for example, in respect of arrears of rent, accrued pre-liquidation or post-liquidation. In *In re Traders' North Staffordshire Carrying Co., Ex parte North Staffordshire Railway Co. (1874) L.R. 19 Eq. 60*, Sir George Jessel M.R. refused to permit a canal company, having statutory powers of distraint for unpaid tolls, to distrain upon goods belonging to a company being wound up. He said, at p. 63:

"In substance it is getting payment by the creditor out of the goods of his debtor, and a preferential payment as between that creditor and the other creditors of the debtor; and, as I understand it, the very object and meaning of the Act of Parliament was to prevent any such preference being obtainable after the commencement of the winding up."

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However, the matter stands differently if the debt, in respect of which the creditor is seeking to exercise a remedy against the company's property, was a new debt incurred by the liquidator for the purposes of the liquidation. In such a case the grant of leave would not be inconsistent with the purpose of the legislation. In such a case it is just and equitable that the burden of the debt should be borne by those for whose benefit the insolvent estate is being administered. The court should exercise its discretion accordingly. The creditor should be at liberty to enforce his rights against the company's property if his debt is not paid in full. Further, and by way of corollary, since the debt was incurred for the purposes of the liquidation, it is properly to be regarded as an expense of the liquidation and it ought to be paid as such. The court will direct the liquidator accordingly.

This latter principle is not confined to new debts incurred by the liquidator. It applies also to continuing obligations under existing contracts such as leases which the liquidator chooses to continue for the benefit of the winding up. Thus, the principle is applicable in respect of rent accruing due while a liquidator retains leasehold land for the purpose of the winding up. The lessor should be paid in full, or be allowed to distrain. The principle is equally applicable in the case of other liabilities incurred in the course of winding up; for example, where rates become due in respect of land occupied by a liquidator for the purpose of the winding up: see *In re International Marine Hydropathic Co. (1884) 28 Ch.D. 470*. Indeed, the principle is of general application to the outgoing on property the possession of which is retained for the purpose of more advantageously winding up the affairs of the company: see *per Baggallay L.J. in In re National Arms and Ammunition Co. (1885) 28 Ch.D. 474, 478*. In *In re Lundy Granite Co., Ex parte Heaven (1871) L.R. 6 Ch.App. 462*, James L.J. stated the underlying principle in a landlord-tenant context, at p. 466:

"But in some cases between the landlord and the company, if the company for its own purposes, and with a view to the realisation of the property to better advantage, remains in possession of the estate, which the lessor is therefore not able to obtain possession of, common sense and ordinary justice require the court to see that the landlord receives the full value of the property. He must have the same rights as any other creditor, and if the company choose to keep the estates for their own purposes, they ought to pay the full value to the landlord, as they ought to pay any other person for anything else, and the court ought to take care that he receives it."

Likewise Lindley L.J. in *In re Oak Pitts Colliery Co. (1882) 21 Ch.D. 322, 330*:

"If the liquidator has retained possession for the purposes of the winding up, or if he has used the property for carrying on the company's business, or has kept the property in order to sell it or to do the best he can with it, the landlord will be allowed to distrain for rent which has become due since the winding up . . . When the liquidator retains the property for the purpose of advantageously disposing of it, or when he continues to use it, the rent of it ought *523 to be regarded as a debt contracted for the purpose of winding up the company, and ought to be paid in full like any other debt or expense properly incurred by the liquidator for the same purpose, and in such a case it appears to us that the rent for the whole period during which the property is so retained or used ought to be paid in full without reference to the amount which could be realised by a distress."

The same approach is applicable in respect of interest accruing due on a debt secured by a mortgage on property retained by a liquidator for the purposes of the winding up: see *In re Brown, Bayley & Dixon, Ex parte Roberts and Wright (1881) 18 Ch.D. 649*, where a mortgagee had power to distrain in respect of unpaid interest. But in practice courts have been less ready to apply this principle in favour of mortgagees: see *In re Lancashire Cotton Spinning Co., Ex parte Carnelley (1887) 35 Ch.D. 656* and *In re Higginshaw Mills and Spinning Co. [1896] 2 Ch. 544*.

It is important to keep in mind that this principle, relating to outgoing on property retained by a liquidator for the purposes of the winding up, is no more than a principle applied by the court when exercising its discretion in a winding up. The principle, which it will be convenient to call the "liquidation expenses" principle, is a statement of how, in general, the court will exercise its discretion in a common form set of circumstances. The liquidator himself has power, in a suitable case, to pay the relevant outgoing. But the court retains an overriding discretion, to give leave under [section 130\(2\)](#) or to give directions to a liquidator that the relevant outgoing shall be paid by him as an expense of the liquidation. Baggallay L.J. drew attention to this in *In re National Arms and Ammunition Co., 28 Ch.D. 474, 477*:

"under section 87 the court has power to allow the distress to be levied in proper cases. The same principles must guide the discretion of the court, whether the application is in the shape of an application for leave to distrain, or of an application for payment." (Emphasis added.)

Likewise Sir John Pennycuik V.-C. in *In re Downer Enterprises Ltd. [1974] 1 W.L.R. 1460*. There a liquidator retained a lease with a view to selling it as soon as practicable. One of the issues before the Vice-Chancellor was whether the lessor would have been entitled to have the arrears of rent accruing since the commencement of the liquidation paid in full as an expense of the liquidation. Sir John Pennycuik V.-C. said, at p. 1465:

"It is on those facts that I have to consider the issue of law . . . which may be stated in these terms: Was Prudential entitled, as against the company, to be paid rent in full after the commencement of the winding up; or, perhaps more accurately: Would the court, in the exercise of its discretion, and applying certain established principles, have so directed? . . . Strictly,

the court has a discretion as to whether to allow arrears to be paid in full in such circumstances, but that is a judicial discretion which the court exercises upon well established principles."

*524

The use of property by an administrative receiver

The second preliminary matter concerns the expenses incurred by a company in the conduct of its business when under the management of an administrative receiver. Typically, when lending money to a company, a bank will take as security a charge over all or most of the assets of the company, present and future, the charge being a fixed charge on land and certain other assets, and a floating charge over the remaining assets. The deed authorises the bank to appoint a receiver and manager of the company's undertaking, with power to carry on the company's business. Such a receiver is referred to in the Act of 1986 as an "administrative receiver."

Normally the deed creating the floating charge and authorising his appointment provides that an administrative receiver shall be the agent of the company. Now the Act of 1986, in [section 44\(1\)\(a\)](#) , provides that this shall always be so, unless and until the company goes into liquidation. For many years the position regarding a receiver appointed as agent of the company was that in general he was not personally liable for contracts entered into by him for and on behalf of the company. He was no more personally liable than was a director who entered into a contract for and on behalf of his company. This position was changed by section 87(2) of the Companies Act 1947 . The position now, with regard to administrative receivers, is set out in [section 44\(1\) and \(2\)](#) of the Act of 1986. Under that section an administrative receiver is personally liable on (a) any contract entered into by him in the carrying out of his functions, except in so far as the contract otherwise provides, and (b) on any contract of employment "adopted" by him in the carrying out of those functions. In the latter regard the administrative receiver has, in effect, a period of 14 days' grace after his appointment. Head (b) represents a statutory overruling of the effect of the decision in *Nicoll v. Cutts* [1985] B.C.L.C. 322 . In cases where he is personally liable an administrative receiver is entitled to an indemnity out of the assets of the company: [section 44\(1\)\(c\)](#) . But even today an administrative receiver is not, in general, personally liable, and hence the statutory indemnity out of the assets of the company does not arise, in respect of contracts adopted by him in the course of managing the company's business, other than contracts of employment. With that one special exception, personal liability is confined, in general, to new contracts made by him. Thus he is not personally liable for the rent payable under an existing lease, or for the hire charges payable under an existing hire-purchase agreement. This is not a surprising conclusion. It does not offend against basic conceptions of justice or fairness. The rent and hire charges were a liability undertaken by the company at the inception of the lease or hire-purchase agreement. The land or goods are being used by the company even when an administrative receiver is in office. It is to the company that, along with other creditors, the lessor and the owner of the goods must look for payment.

Nor is a lessor or owner of goods in such a case entitled to be paid his rent or hire instalments as an "expense" of the administrative receivership, even though the administrative receiver has retained and used the land or goods for the purpose of the receivership. The reason *525 is not far to seek. The appointment of an administrative receiver does not trigger a statutory prohibition on the lessor or owner of goods such as that found in [section 130](#) in the case of a winding up order. If the rent or hire is not paid by the administrative receiver the lessor or owner of the goods is at liberty, as much after the appointment of the administrative receiver as before, to exercise the rights and remedies available to him under his lease or hire-purchase agreement. Faced with the prospect of proceedings, an administrative receiver may choose to pay the rent or hire charges in order to retain the land or goods. But if he decides not to do so, the lessor or owner of goods has his remedies. There is no occasion, assuming that there is jurisdiction, for the court to intervene and order the administrative receiver to pay these outgoings.

Part II of the Act of 1986

Against that background and with those principles in mind, we turn to consider the position of administrators appointed under the Act of 1986. Part II of this Act represents a major reform in the law relating to companies which are insolvent or likely to become so. The statute enables the court to appoint an administrator to manage the affairs, business and property of a company with a view to achieving one or other of the statutory objectives set out in [section 8\(3\)](#) . This reform was introduced by the [Insolvency Act 1985](#) following proposals on insolvency law and practice made in June 1982 by a committee under the chairmanship of Sir Kenneth Cork, the Report of the Review Committee: Insolvency Law and Practice (1982) (Cmnd. 8558). The committee considered that the power, contained in any well-drawn floating charge, to appoint a receiver and manager of the property and

undertaking of a company had been of outstanding public benefit. A significant number of companies had been forced into liquidation, and potentially viable businesses capable of being rescued had been closed down, for want of such a floating charge. The committee proposed that statutory provision should be made enabling an administrator to be appointed in appropriate circumstances, with all the powers normally conferred upon a receiver and manager appointed under a floating charge.

The statutory scheme, as enacted, makes clear that an administrator is intended as a statutory alternative to an administrative receiver. An administrator is intended to fill the lacuna perceived to exist in the case of insolvent companies where either there is no floating charge or the holder of a floating charge does not appoint an administrative receiver. Thus section 9(3) provides that if an administrative receiver has been appointed the court cannot make an administration order unless the person on whose behalf the administrative receiver was appointed consents or unless the security by virtue of which the administrative receiver was appointed is impeachable. When an administration order is made any administrative receiver vacates office, and while an administration order is in force no administrative receiver may be appointed: section 11(1)(b) and (3)(b). Further, there are some similarities between administrators and administrative receivers. For instance, an administrator's powers expressly include the same wide **526* powers as those conferred by the Act on administrative receivers: sections 14(1)(a) and 42, and Schedule 1 .

The statute addresses the question of expenses incurred by an administrator, but only in the context of what is the position when a person ceases to hold office. Section 19(4) provides that the remuneration of an administrator and "any expenses properly incurred by him" shall be charged on and paid out of any property of the company in his custody or under his control when he ceases to be administrator in priority to any security to which section 15(1) applies. Section 15(1) applies to any security which, as created, was a floating charge. Section 19(5) provides:

"Any sums payable in respect of debts or liabilities incurred, while he was administrator, under contracts entered into or contracts of employment adopted by him or a predecessor of his in the carrying out of his or the predecessor's functions shall be charged on and paid out of any such property as is mentioned in subsection (4) in priority to any charge arising under that subsection. For this purpose, the administrator is not to be taken to have adopted a contract of employment by reason of anything done or omitted to be done within 14 days after his appointment."

There is a striking resemblance between the debts and liabilities to which this subsection applies in the case of an administrator, and the debts and liabilities in respect of which an administrative receiver is personally liable pursuant to section 44 . Section 19(5) does not impose personal liability on the administrator. In that respect he is in a better position than an administrative receiver, even though his status resembles that of an administrative receiver in that in exercising his powers he is deemed to act as the company's agent: section 14(5). But in section 19(5) Parliament addressed, although in a somewhat oblique fashion, the position regarding debts and liabilities arising under contracts entered into or adopted by an administrator in the carrying out of his functions. The answer supplied by Parliament was that, as in the case of administrative receivers, no special provision was made for debts and liabilities incurred during an administration under a contract adopted by the administrator, save in the one case of contracts of employment. This answer is important, having in mind that one of the primary functions of an administrator is that frequently, if not normally, he will continue to carry on the company's business and, hence, will continue to use the land and goods currently being used by the company for the purposes of its business. Indeed, it is of the essence of his appointment that an administrator should do these very things in cases when the purpose sought to be achieved by the administration order is purpose (a) in section 8(3) , namely the survival of the company, and the whole or any part of its undertaking, as a going concern.

If the relevant statutory provisions had ended there we would have seen no reason to doubt that Parliament must have intended, as Mr. Heslop submitted, that the position regarding outgoing on property used by the company during an administration should be similar to that obtaining in an administrative receivership. But that would be to ignore **527* a crucial part of the statutory structure. Parliament considered that an administrator should be buttressed with a support which an administrative receiver does not have. That support encroaches upon the property rights of others. Section 11(3) provides:

"During the period for which an administration order is in force - (a) no resolution may be passed or order made for the winding up of the company; (b) no administrative receiver of the company may be appointed; (c) no other steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as the court may impose; and (d) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as aforesaid."

Thus the making of an administration order triggers the like prohibition on proceedings being brought or continued against the company as the prohibition which exists, and has long existed, when a winding up order is made. The owners of property, and of charges over property, are disabled from exercising their proprietary rights unless the administrator consents or the court gives leave.

We regard this feature as of cardinal importance, distinguishing an administration from an administrative receivership in a respect vital to the matter now under consideration. This feature, coupled with the further feature that the court has power to give directions to the administrator on the conduct of the administration, leads inexorably to the conclusion that much of the reasoning which caused the courts to adopt what we have referred to as the "liquidation expenses" principle in the case of liquidations is also applicable in administrations but subject, in our view, to a very important qualification. In liquidations the principles on which the court will exercise its discretion have hardened into a set practice, both in relation to "possession" cases and in the application of the "liquidation expenses" principle. In "possession" cases leave is granted as of course, and in the circumstances in which the "liquidation expenses" principle is applicable, entitlement to have the outgoing payments as an expense of the liquidation seems to have become more or less automatic. In our view there is no place for comparable hard-and-fast principles in the case of administrations. The reason for this difference is that the objectives of winding up orders and administration orders are different and, hence, the approach that should be adopted by the court when exercising its discretion under the two régimes is different. In the case of winding up the company has reached the end of its life. The basic object of the winding up process, in the case of an insolvent company, is to achieve an equal distribution of the company's assets among the unsecured creditors. A secured creditor will not, as such, participate in the ensuing distribution. If he seeks leave to obtain possession of his own property, leave should be granted, and if *528 another's land or goods (and we can see no relevant difference between them, for this purpose) are detained by the liquidator against the owner's wishes and used for the purposes of the winding up, it is obviously only fair that in respect of the period of detention the owner should be paid his rent or hire charges in full as expenses of the liquidation.

In contrast, an administration is intended to be only an interim and temporary regime. There is to be a breathing space while the company, under new management in the person of the administrator, seeks to achieve one or more of the purposes set out in section 8(3). There is a moratorium on the enforcement of debts and rights, proprietary and otherwise, against the company, so as to give the administrator time to formulate proposals and lay them before the creditors, and then implement any proposals approved by the creditors. In some cases winding up will follow, in others it will not. Whether those whose land or goods are being used by the company during this interim period should be given leave to enforce their proprietary rights forthwith or should be paid ahead of everyone else must depend on all the circumstances, which will vary widely from one case to the next. We do not think that Parliament intended, for example, that if a company's factory or offices are leasehold, and the administrator continues to carry on the business on those premises, the court as a matter of course would always give leave to re-enter, or to distrain in respect of rent accruing from the date of the administration order, or make a direction for payment of the rent in full as an expense of the administration. Likewise in respect of vehicles or machinery which are in the company's possession under hire-purchase agreements and which are being used by a company in the course of carrying on its business. Parliament must have intended, for instance, that, in appropriate circumstances, and for a strictly limited period, such a lessor or owner of goods might not be given leave if giving leave would cause disruption and loss out of all proportion to the loss which the lessor or the owner of goods would suffer if leave were refused. Indeed, Parliament must have intended that when exercising its discretion the court should have due regard to the property rights of those concerned. But Parliament must also have intended that the court should have regard to all the other circumstances, such as the consequences which the grant or refusal of leave would have, the financial position of the company, the period for which the administration order is expected to remain in force, the end result sought to be achieved, and the prospects of that result being achieved.

If this flexible approach is right, there is no room in administrations for the application of a rigid principle that, if land or goods in the company's possession under an existing lease or hire-purchase agreement are used for the purposes of an administration, the continuing rent or hire charges will rank automatically as expenses of the administration and as such be payable by the administrator ahead (so it would seem) of the pre-administration creditors. Nor, even, for a principle that leave to take proceedings will be granted as of course. Such rigid principles would be inconsistent with the flexibility that, by giving the court a wide discretion, Parliament must have intended should apply.

*529

This conclusion is consistent with section 19(5). If an administrator adopts an existing contract of employment, the liabilities arising under that contract are automatically payable as provided in that subsection. As to other existing contracts "adopted" by an administrator, creditors have no automatic preference or priority.

We recognise that if a lessor or owner of goods is not to have any such automatic priority, this will be a powerful factor in favour of leave being granted to him to enforce his proprietary rights. So be it. At a later stage we shall turn to consider the principles guiding the exercise of the discretion to grant or withhold leave.

We also recognise that, if a lessor or owner of goods is not to have any such automatic priority, it might seem, at first sight, that the financial interests of lessors and owners of goods will dictate that, as soon as they learn of an administration order, they should make an application to the court for leave to take proceedings. We do not think that this conclusion follows. An administrator can give his consent under the section. Further, an administrator undoubtedly has power, in an appropriate case, to pay rent and hire charges in respect of land and goods used by him for the purposes of the administration. This is so both as to arrears and as to amounts continuing to fall due. Under the Act he has power to make any payment which is necessary or incidental to the performance of his functions: [paragraph 13 of Schedule 1](#) . When deciding whether or not to give his consent or to exercise this power, an administrator will need to consider whether the case is one in which, if an application were made to the court by the lessor or owner of goods, the court would be likely to give leave, or to give leave unless some or all of the rent or hire charges were paid by the administrator. If it is such a case, and if the lessor or owner of the goods is seeking possession, the administrator should consider whether, having regard to those features and all the other circumstances of the case, he ought to give consent or ought to pay some or all of the rent or hire charges of the land or goods if he wishes to continue to use them.

An administrator is an officer of the court. He can be expected to make his decision speedily, so far as he can do so. He may be able at least to make an interim decision, such as agreeing to pay the current rents for the time being. The administrator should also make his decision responsibly. His power to give or withhold consent was not intended to be used as a bargaining counter in a negotiation in which the administrator has regard only to the interests of the unsecured creditors. When he refuses consent it would be helpful if, unless the reason is self-evident, he were to state succinctly why he has refused and also why he is not prepared to pay the rental arrears or at least the current rentals. A similar approach should be adopted by the administrator when secured creditors seek his consent to enforce their security. It should not be necessary, therefore, for the Companies Court to be swamped with applications under [section 11](#) , or for administrations to be subjected regularly to the expense and disruption of such applications. Should it become necessary for a lessor or owner of goods or the owner of a security to make an application to the court, the court has ample powers, by making orders as to costs and giving directions to the [*530](#) administrator, either as its own officer or as envisaged by [section 17](#) , to ensure that the applicant is not prejudiced by an unreasonable decision of an administrator.

We must note two other points. It was argued that, unless lessors of land and owners of goods let on hire-purchase terms which are used by an administrator in the course of his administration are entitled of right to be paid the continuing rent and hire charges as an expense of the administration, the result would amount to expropriation by statute without compensation. An intention to take away the property of a subject without a right to compensation is not to be imputed to Parliament unless that intention is expressed in unequivocal terms: see *per* Lord Atkinson in [Central Control Board \(Liquor Traffic\) v. Cannon Brewery Co. Ltd. \[1919\] A.C. 744](#) , 752. We do not think this line of argument assists. To the extent that the prohibition in section 11 precludes an owner of land or goods from exercising his proprietary rights, section 11 does have an expropriatory effect. But that is provided for in unequivocal terms. The safety valve which Parliament has built into the system is the owner's ability to make an application to the court. Built into section 11 itself is provision for an application to the court for leave, in the absence of agreement by the administrator. Further, Parliament provided that the administrator should manage the affairs, business and property of the company, at any time before proposals have been approved by the creditors under [section 24](#) , "in accordance with any directions given by the court:" [section 17](#). Still further, there is the long-stop safeguard provided by [section 27](#) . On the hearing of a petition under that section the court has wide powers, including power to discharge the administration order and make consequential provision. Given these discretionary safeguards, we can see no justification for reading into the statutory provisions an implication that the owner of land or goods was intended to have some other remedy to compensate for any loss he suffers by reason of the section 11 prohibition.

The second point we must note briefly is a contention by Norwich and A.I.B. to the effect that, even if they are not entitled of right to be paid the sums due under the headleases from the date of the administration order as expenses of the administration, they became so entitled after the lapse of a reasonable period of time within which the administrators could make up their minds whether they wished to continue to retain the head leases. We do not agree. At bottom this contention is the same as the principal argument advanced, save that it incorporates "thinking time." But the essential difficulty remains. This modified contention, as much as the primary contention, is inconsistent with the court having been given a wide discretion, in exercise of which, in appropriate circumstances, the court may refuse leave under [section 11](#) even though the administrator is continuing to use land or goods belonging to another without payment in full of the current rent and hire charges.

For these reasons we cannot accept that Norwich and A.I.B. have an absolute entitlement to be paid, as an administration expense, the rent *531 and other outgoings payable under the headleases. On this we have to part company with the judge.

"Goods in the company's possession"

The next question which arises concerns the proper meaning of the expression "goods in the company's possession" in section 11(3)(c). This paragraph prohibits steps being taken "to repossess goods in the company's possession under any hire-purchase agreement," except with consent or leave. By section 10(4), reference to hire-purchase agreements include conditional sale agreements, chattel leasing agreements and retention of title agreements.

The computer equipment in this case is for the most part on the premises of end users, to whom it has been sublet by the company. Can it still be said to be in the possession of the company for the purposes of section 11(3)(c)? The judge thought not. That is certainly a very arguable view, although it produces the curious result that the funders can take steps to repossess the equipment without consent or leave, but consent or leave is needed for A.I.B. to enforce its security over the income arising under the subleases of the same equipment. Plainly for some purposes the equipment is in the possession of the end users. If it matters, which is open to question, the parties contemplated and provided that this would happen. For example, the master hire-purchase agreement between A.I.B. and the company provided by clause 7.01 that the goods should be "located at the site," meaning the address of the end user; and by clause 9.01, that the company should not "part with possession of any of the goods," *except* that the company should be entitled to sublease them. A typical sublease by the company contains a covenant (in clause 9) that the sublessee "shall peaceably and quietly hold possess and use" the goods. By clause 12(iii) upon termination the company "shall immediately be entitled to the possession" of them.

In *Towers & Co. Ltd. v. Gray* [1961] 2 Q.B. 351, 361, Lord Parker C.J. said:

"The term 'possession' is always giving rise to trouble. As Earl Jowitt said in *United States of America and Republic of France v. Dollfus Mieg et Cie. S.A. and Bank of England* [1952] A.C. 582, 605: 'The person having the right to immediate possession is, however, frequently referred to in English law as being the "possessor" - in truth the English law has never worked out a completely logical and exhaustive definition of "possession."' For my part I approach this case on the basis that the meaning of 'possession' depends upon the context in which it is used . . . In some contexts, no doubt, a bailment for reward subject to a lien, and where perhaps some period of notice has to be given before the goods can be removed, could be of such a nature that the only possession that there could be said to be would be possession in the bailee. In other cases it may well be that the nature of the bailment is such that the owner of the goods who has parted with the physical possession of them can truly be said still to be in possession."

*532 That in itself does not provide a solution to this point, since it contemplated that either the bailor or the bailee may have possession for a given purpose - but not both. However, it does contemplate that for some purposes a bailor, and therefore a sub-bailor, may still have possession despite the bailment.

In our judgment the answer emerges once one considers the purpose of section 11(3)(c). The paragraph is dealing with goods which, as between the company and its supplier, are in the possession of the company under a hire-purchase agreement. Those goods are to be protected from repossession unless there is either consent or leave. It is immaterial whether they remain on the company's premises, or are entrusted by the company to others for repair, or are sublet by the company as part of its trade to others. We do not see that such a construction does any violence to the language of the paragraph, or is more purposive than is warranted by the current approach of the English courts to statutes which are neither fiscal nor penal, even though it is said that a breach of the paragraph is a contempt of court.

In the present case the computer equipment, as between the funders and the company, remains in the possession of the company. Accordingly it is in the company's possession for the purposes of section 11(3)(c), so that it cannot be repossessed save with consent or leave.

Mr. Crystal gave an example of goods bailed by the owner to X, by X to Y, and by Y to Z; X then goes into administration; and Y, for quite different reasons such as that he has not received a hire payment, wishes to repossess from Z. Mr. Crystal submitted that, if the construction which the administrators contend for is correct, Y would need either consent or leave. It is hard to see how the administrator of X would have any reason to refuse consent; but we do not think that it would be needed. Paragraph (c) is dealing with steps to repossess by a person who has let goods on hire-purchase to the company, and possibly by somebody

with a higher right than that person. The paragraph does not deal with a repossession which would not affect the company's enjoyment of the goods or the profit flowing to the company from them.

Fixed or floating charges

In some instances the company assigned the benefit of subleases to funders. Nothing turns on this so far as Norwich is concerned. Norwich did not seek to rely on any such assignments in this case, although it has reserved the right to do so on another occasion. As to A.I.B., there were such assignments, by way of charge, in respect of every sublease, and these were duly registered under the Companies Act. In respect of these charges the administrators advanced a contention that the charges were floating charges and not fixed charges, and that leave to enforce them should not be given at this stage, because that would enable A.I.B. to defeat a potential charge under [section 19\(4\) and \(5\)](#). It is convenient to consider this issue next.

The deed of assignment dated 9 June 1988 and made between the company and A.I.B. contains provisions which are typical on the material point. The recitals to the deed identified, by reference to schedules, certain hire-purchase agreements, or headleases, as we have [*533](#) called them, and also the matching subleases. The operative clause in the deed provided:

"In consideration of [A.I.B.] having agreed to enter into the [headleases] and as security for all the moneys, obligations and liability (if any) due by the [company] under or by virtue of the [headleases] the [company] as beneficial owner hereby assigns to [A.I.B.] by way of security all the benefit of the terms of each of the subleases and all rentals, claims, rights, demands and other moneys or claims for moneys whatsoever under each of the subleases which the [company] has or may at any time in the future have or be entitled to under or by virtue of the subleases (hereinafter referred to as 'the assigned benefits') so that the assigned benefits in respect of each sublease shall be and are assigned to [A.I.B.] to secure the obligations of the [company] under the [headlease] corresponding thereto in accordance with recital (C) above."

We were reminded of the well known descriptions of a floating security given in *In re Yorkshire Woolcombers Association Ltd. [1903] 2 Ch. 284*, 286. There the property charged was "all and singular the book and other debts now owing to the association, and also all . . . the book and other debts which may at any time during the continuance of this security become owing to the association." Romer L.J. said, at p. 295:

"I certainly do not intend to attempt to give an exact definition of the term 'floating charge,' nor am I prepared to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics that I am about to mention, but I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."

In the House of Lords in *Illingworth v. Houldsworth [1904] A.C. 355* the Earl of Halsbury L.C. referred to the charge in that case and stated what he considered to be the essential characteristic of a floating security, at p. 357:

"In the first place you have that which in a sense I suppose must be an element in the definition of a floating security, that it is something which is to float, not to be put into immediate operation, but such that the company is to be allowed to carry on its business. It contemplates not only that it should carry with it the book debts which were then existing, but it contemplates also the possibility of those book debts being extinguished by payment to the company, and that other book debts should come in and take the place of those that had disappeared. That . . . seems to me to be an essential characteristic of what is properly called a floating security."

[*534](#) Lord Macnaghten also emphasised the ambulatory nature of a floating charge, at p. 358:

"I should have thought there was not much difficulty in defining what a floating charge is in contrast to what is called a specific charge. A specific charge, I think, 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 affect 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."

In the light of these observations we cannot accept Mr. Heslop's submissions. The notable feature of the present case is that the charges were not ambulatory. The property assigned by the company was confined to rights to which the company was entitled under specific, existing contracts. The assignments consisted of the company's rights "under or by virtue of" subleases each of which was already in existence at the time of the assignments and each of which was specifically identified in the relevant deeds of assignment. In each case the payments due to the company under a specific sublease were charged as security for the payments due by the company under the headlease relating to the same equipment. The company's right to receive future instalments from end users in due course pursuant to the terms of these subleases was as much a present asset of the company, within Romer L.J.'s reference to "present and future" assets of a company, as a right to receive payment of a sum which was immediately due. Romer L.J.'s reference to future assets was a reference to assets of which, when the charge was created, the company was not the owner. That was the position in that case. That is not the position in this case.

We have in mind that in practice sums payable by the end users under these subleases were paid to the company and utilised by it in the ordinary course of business. In so far as this is relevant, it may well be that this was what the parties intended should happen. The company was to be at liberty to receive and use the instalments until A.I.B. chose to intervene. We are unpersuaded that this results in these charges, on existing and defined property, become floating charges. A mortgage of land does not become a floating charge by reason of the mortgagor being permitted to remain in possession and enjoy the fruits of the property charged for the time being. This is so even if the land is leasehold and the term is very short, and as such the asset charged is of a wasting character. So here: the mere fact that for the time being the company could continue to receive and use the instalments does not suffice to negative the fixed character of the charge. This apart, we have seen nothing to lend any support to the administrators' contention. In particular, we have seen nothing to suggest that after the assignment the company was to be at liberty to deal with its rights under the subleases without the consent of A.I.B. *535 *The applications under section 11*

We turn next to the applications for leave to terminate the headleases and to take steps to repossess the equipment and, in the case of A.I.B., to enforce its security. The following are the factors of importance in this case on these applications.

(1) The headleases and the subleases

First, the funders' property. A typical hire-purchase agreement between the company and a funder runs for seven years. The rent is payable quarterly in advance, and the amount varies in accordance with fluctuations in interest rates in the financial market. At current rates of interest, the amount due to Norwich under the relevant head leases between the date of the administration order and 1996 is about £24m. A.I.B.'s exposure, in respect only of capital, is about £6m.

Broadly the provisions of the subleases match the provisions of the corresponding headlease, with two exceptions. First, as to the amount of the rent. In a typical case, although the rent payable by the company under the headleases fluctuates, the rent payable by end users to the company under the subleases is of a fixed amount. Thus the company was vulnerable to upward movements in interest rates. Most of the relevant subleases were entered into by the company in 1986 and 1987, when interest rates were much lower than at present. In some instances the present shortfall, between the rate of interest receivable by the company from end users and the rate of interest payable by the company to the funders, is as much as 10 per cent. The administrators estimate that, over the life of the headleases and subleases, the overall deficit for the company will be of the order of £20m. The deficit for the three-month period from the date of the administration order to 18 July was about £1.7m.

The second respect in which the headleases and subleases do not correspond is that, either from the outset or by reason of subsequent variation, the subleases generally contain a "flex" option. Two-thirds of them also contain a "walk" option. A "flex" option entitles an end user to upgrade his equipment, generally after three years, and enter into a further sublease on certain terms. The company undertook to settle all charges remaining to be paid to the funder under the original head- lease. A "walk" option entitles an end user to return his equipment before the end of the sublease term, usually after five years. Here also the result of the exercise of the option is that the company is liable to pay the future rental payments under the headlease.

By reason of the non-payment of the rental instalments under the headleases, if for no other reason, Norwich and A.I.B. are now entitled, in accordance with the terms of their headleases, to determine the headleases.

There is a measure of dispute between the parties on how quickly the subleased computer equipment becomes obsolescent. Clearly, however, one would expect that if the computers had to be repossessed and sold, they would not, in general, fetch anything approaching their original value. Undoubtedly the best hope for Norwich and A.I.B. is to tap into the stream of income whose source is the end users, and to do *536 so either by seeking to take over the benefit of the existing subleases or by negotiating a new and better deal with the end users.

(2) The company's financial position

At the time of the hearing of the appeal, no statement of affairs had been produced by the directors of the company. The most up-to-date information on the company's financial position is contained in the administrators' statement circulated to the creditors on 24 June along with the notice convening the creditors' meeting. The financial affairs of the company and of the Atlantic group as a whole are complex. Uncertainty and obscurity abound. In relation to the headleases and subleases the administrators have been hampered by the state of the records and system of information storage and retrieval operated by the company. For present purposes the position can be sufficiently summarised as follows. The administrators do not expect that the assets of the company will yield anything remotely approaching their book value. Inter-company debts, for instance, have a book value of nearly £110m., but they are unlikely to yield more than a few pence in the pound. The company's principal asset comprises the subleases: this type of transaction forms the core of the company's business. The book value of the subleases is £96m. In addition, "own book" leases have a book value of £10m. "Own book" leases, which form only a small part of the company's business, are transactions where the company itself funded the acquisition of the computers and is itself the owner of the equipment let to end users. Against these assets are to be set liabilities, estimated at about £130m., arising under the headleases. In addition, there are or will be liabilities arising under the flex and walk options in the subleases. Accrued liabilities under this head are estimated at about £12m., and contingent liabilities at the massive sum of £250m. Other debts, in respect of tax, trade creditors and inter-company creditors, are estimated at £60m.

(3) The administrators' proposals

Third, the way ahead. The administrators are not looking for new business. As to realisations, there is no question of the company's interest in the headleases and subleases being sold en bloc. Most subleases have been tailored to meet the specific circumstances of particular end users. The result is a complex portfolio of headleases and subleases which have to be dealt with on an individual basis. The administrators have stated their general objectives as: "extracting value from leases where it exists and of minimising actual and contingent claims in all cases by agreement between the parties." In their statement of 24 June the administrators continued:

"The insolvency of [the company] leaves users and funders with a problem. The contracts with [the company] gave the users the ability to extricate themselves before the end of the lease term in accordance with their computer requirements. The intention is, through negotiations, to allow the user to regain control of his future computer requirements whilst minimising claims on [the *537 company]. In addition we are in discussions with third parties, who are attracted by [the company's] customer base, with a view to introducing them in exchange for value to [the company], into this management process."

The reference to the company's customer base is to the fact that the end users include many "blue chip" companies.

Attaining these objectives is not expected to be a speedy process. The administrators consider that significant realisations could take "some considerable time."

A meeting of the company's creditors, convened to consider the administrators' proposals in accordance with [section 23](#), was held on 11 July. By a majority the creditors approved the proposals with some modifications. The main proposals as approved were:

"2. To administer [the company's] lease portfolio to the benefit of all the company's creditors, or potential creditors, in so far as this is possible. 3(a) To seek, in co-operation with funders and users of equipment, an approach which allows [the company] to withdraw from its contractual arrangements with funders and lessees as soon as possible on mutually agreeable terms and in particular: (1) to make an immediate joint approach with funders to lessees to direct lessees henceforth to make all payments due under subleases direct to funders; . . . and (2) if payments are not resumed within a reasonable time, or if it becomes apparent that compromises cannot be reached, the administrators shall be entitled to give any consents requested by the funders to exercise their rights under their relevant lease or hire-purchase agreements and associated

security documents. (b) To manage individual situations on leases and customer relationships to realise value for the creditors as a whole with the agreement of interested parties. (c) To introduce third parties to take over leases and, where possible, any associated liabilities. (d) To formulate arrangements whereby agreement is reached with lessees and funders so that they reduce their claims against [the company] and/or pay a consideration to allow the leases to continue without the involvement of [the company]."

Further proposals were: to pursue the company's interest in other group companies; to maximise tax benefits; to report to the creditors' committee within three months; to assess the impact of the outcome of this appeal and to formulate any revised proposals which may become necessary; and in due course to apply for a discharge on the basis that the company is wound up.

In addition, we were informed by a letter from the administrators' solicitors, written after the creditors' meeting and after we had reserved judgment, that the administrators now intend to pay forthwith to the funders all amounts received by the company since 18 April under subleases which correspond to headleases with the respective funders. The payments will be made with accrued interest. Where the funder does not have a registered security over the sublease payments, the funders will not receive any amount which relates to a period for which the relevant funder has already received payment from the company. *538

(4) The effect on the administration if leave were given

If leave were given to terminate the headleases and repossess the equipment, the administrators would be in a much weaker position in negotiations with the end users and the funders in those cases where the funders took advantage of such leave. If leave were given to Norwich and A.I.B., other funders similarly placed would be entitled to expect that they, too, would be given leave. We have no evidence about the views of other funders on these matters. The likely result, if other funders sought to pursue the same course as Norwich and A.I.B., would be the wholesale collapse of the administrators' basic proposals. Each of the numerous funders, of whom there are about 50, would take his own steps against the end users, of whom there are nearly 1,000. The flex and walk liabilities could be expected to crystallise into claims against the company. The administrators' hopes of substantially reducing these claims would disappear. Any goodwill remaining in the customer base would evaporate. Likewise if leave were given to A.I.B. to enforce its security over the subleases: in those cases the administrators would be squeezed out.

(5) The effect on Norwich and A.I.B. if leave were refused

If leave to terminate the headleases and to repossess were not given, the effect on Norwich and A.I.B. would be that they would be likely to suffer significant loss. The sums involved are substantial. The underlying property is a wasting asset. Given the company's insolvent state and the contingent liabilities under the flex and walk options, there may be difficulty in persuading end users to resume payments in full under the subleases at once, while negotiations proceed. Even if such payments were resumed and duly handed over to the funders, there would still be a significant shortfall compared with the rents due to the funders under the headleases.

Mr. Heslop did not accept that Norwich and A.I.B. would suffer loss if leave were refused. He submitted that Norwich and A.I.B. cannot reasonably expect to receive more than the amount of the subrentals, and they will receive that under the proposals. Norwich and A.I.B. knew that the equipment was being sublet, so they cannot oust the end users from their possession of the equipment. Nor, indeed, can they even intercept the stream of income from the end users to the company, because they are not parties to the subleases. A.I.B., as assignee of the benefit of the subleases, can enforce its security, but qua owners A.I.B. and Norwich can achieve nothing by terminating the headleases. We are wholly unpersuaded that this is a complete analysis. We are satisfied that if Norwich and A.I.B. were given leave to pursue whatever remedies are lawfully available to them as owners of the equipment, they would be in an appreciably stronger position, both against the end users and against the company, than they are at present.

(6) The prospects of a successful outcome in the administration if leave were refused

If leave were refused, we would expect that over a protracted period the administrators would be able to negotiate deals with end users which *539 would reduce their claims against the company. After all, the company is insolvent. It would make sense for end users to renegotiate their deals. As to the funders, it may well be that there would be a better prospect of obtaining their consent to a proposed deal if leave were refused than if it were given, but that would be because in the former case the

funders would find themselves disabled in the negotiations from relying on their proprietary rights. The essential question in this case is whether that would be right.

(7) The conduct of the parties

From the very outset of the administration A.I.B. sought the administrators' consent to the realisation of its security. Consent to terminate the headleases was sought by A.I.B. in a letter of 4 May. Norwich Union made a request to the same effect by a letter of 10 May. There is no question here of either applicant having disintitiled itself to relief, by acquiescence or election or anything of that nature. Nor is there any question of either Norwich or A.I.B. having been misled by the administrators, or anything of that sort, or of the administrators having dragged their feet in the conduct of the administration.

(8) Conclusions

In this case it is for us sitting in the Court of Appeal to exercise our own discretion. In so far as the question of granting leave arose at all before the judge in view of his decision that the equipment was not in the company's possession, the judge approached the question on the erroneous footing that Norwich and A.I.B. were entitled to be paid the rent due under the headleases as an expense of the administration.

Taking into account all the matters mentioned above, we are in no doubt that this is a case in which we should exercise our discretion under section 11 to grant leave to take steps to terminate the head- leases and to repossess the goods and, in the case of A.I.B., to enforce its security. The administration is a prelude to winding up the company. In short, the administrators propose to negotiate benefits for the unsecured creditors, who to a substantial extent are the end users and funders themselves, by reducing the amount of the claims of the end users and funders. End users will be asked to release their claims under the flex and walk options. They may be asked to pay more, direct to the funders. Funders will be asked to release their claims against the company under the headleases. The unsatisfactory feature of these proposals is that the contemplated negotiations will take place at the expense of the funders, in that the funders will be asked to agree to modify their existing proprietary rights in a negotiation in which they will not be able to rely on those rights. Their bargaining strength will be reduced to the prospect that, if agreement is not reached after an indefinite period, the administrators may give their consent under section 11. Or, presumably, Norwich and A.I.B. could embark on a fresh application to the court. This cannot be an acceptable basis on which to conduct an administration. Norwich and A.I.B. should not be compelled to leave their property in such an administration against their will. The **540* prohibitions in section 11(3)(c) and (d) were not intended to be a means of strengthening an administrator's position if he should seek to negotiate a modification of the existing proprietary rights of the owner of the land or goods in question.

This is not a case in which it is practicable to refuse leave on condition that the administrators pay all the current outgoings under the headleases. The rents from the subleases, even assuming the flow can be restarted promptly, are insufficient for this purpose.

We have in mind that, although it is now over three months since the administration order was made, the parties have been locked in litigation for two of those months. Throughout this period the future of the administration has been clouded in uncertainty. We have considered whether, this being so, it would be right to stay the grant of leave for a while to enable the administrators to consider the way ahead in the light of the outcome of this appeal and, maybe, to submit revised proposals to the creditors. We have decided not to grant such a stay. We see no reason to think that granting a stay would serve a useful purpose. No suggestion was advanced to us of any other particular proposals the administrators would wish to consider further if we were minded to grant leave.

Further directions

There remains the question of what should be done with the sums already collected by the administrators in respect of subleases of equipment belonging to Norwich and A.I.B. respectively. Sensibly and properly, on their appointment the administrators took steps to gather in payments falling due under the subleases. The administrators were under a statutory duty to take into their custody or under their control all the property to which the company was or appeared to be entitled: section 17. Equally sensibly and properly, the administrators placed the money received into earmarked, interest-bearing bank accounts. But what should now happen to that money? Suffice to say, we agree with the administrators' recent decision that the money should be paid to Norwich and A.I.B. with the interest accrued thereon. Had they not so decided, we would have so directed, for reasons which it is not necessary now to elaborate.

On this only one point remains outstanding. Some of the payments received by the administrators from subleases were in respect of periods of time covered, in whole or in part, by payments made in advance to funders under the corresponding headlease. Contrary to the view of the administrators, we do not think that this makes any significant difference, so long as the funders do not receive more than their up-to-date entitlement under the corresponding headlease. We shall therefore direct the administrators to pay to Norwich and A.I.B. all sums received by the administrators since their appointment in respect of equipment owned by Norwich and A.I.B., together with the interest accrued thereon, but subject to the ceiling that the sums paid over shall not exceed the amount of the arrears accrued due under the respective headleases at the time when the administrators make the payments to Norwich and A.I.B. These payments by the administrators shall be on account of the sums due from *541 the company under the relevant headleases, and they shall count as expenses properly incurred by the administrators.

Should we go beyond this and, in the exercise of our discretion, make an order that all the rental and other outgoings which have accrued on the headleases since the administration order shall be paid by the administrators as an expense of the administration? We think not. We consider that the justice of the case is best met by giving leave, and making a direction as just mentioned regarding the money actually received by the administrators. In this way the administrators will account to Norwich and A.I.B. for the benefits received from the continuation of the headleases during the administration. Without prejudice to what may happen hereafter in this administration, we do not consider that we should make any further order at this stage.

In the light of the above we do not think that any question arises on Mr. Crystal's further application, which was for leave to bring proceedings against the company for some form of restitutionary relief in respect of the money received by the administrators from the end users. In any event, we would have refused such leave, without prejudice to his clients' right to re-apply when the nature of this claim and its legal basis have been formulated at least to an extent which will make it possible to assess whether the claim is even arguable.

Norwich's section 27 petition

Thus far we have been concerned with applications by Norwich and A.I.B. seeking various declarations and orders and leave under section 11. Norwich also presented a petition under section 27, on the ground that the administrators' conduct in collecting the rents from the end users but refusing to pay them to the funders was unfairly prejudicial to creditors including Norwich. By this petition Norwich seeks, in short, an order that all the rent and other outgoings arising under the Norwich headleases, whether they accrued before or after the date of the administration order, should rank as expenses of the administration. We have already stated that we shall not make such an order. Since we are giving leave under section 11, there is no case for the further order sought in the section 27 petition, namely, an order discharging the administration order.

Leave applications: the general approach

There is one final matter to which we now turn. In the course of argument we were invited to give guidance on the principles to be applied on applications for the grant of leave under section 11. It is an invitation to which we are reluctant to accede, for several reasons: first, Parliament has left at large the discretion given to the court, and it is not for us to cut down that discretion or, as it was put in argument, to confine it within a straitjacket. However much we emphasise that any observations are only guidelines, there is a danger that they may be treated as something more. Secondly, section 11(3)(c) and (d) applies to a very wide range of steps and proceedings, and the circumstances in which leave is sought will vary almost infinitely. Thirdly, it is the judges who sit in the Companies Court who have practical experience of the difficulties arising in the working out of this new jurisdiction, not the members of this court.

*542

However, we have already drawn attention to the important role of the administrator in this field. He should respond speedily and responsibly to applications for consent under section 11. Parliament envisaged that in the first place section 11 matters should be dealt with by him. It is to be hoped, in the interests of all concerned, that applications to the court will become the exception rather than the rule. But we recognise that for this to be so, authorised insolvency practitioners and their legal advisers need more guidance than is available at present on what, in general, is the approach of the court on leave applications. We feel bound, therefore, to make some general observations regarding cases where leave is sought to exercise existing proprietary rights, including security rights, against a company in administration.

(1) It is in every case for the person who seeks leave to make out a case for him to be given leave.

(2) The prohibition in section 11(3)(c) and (d) is intended to assist the company, under the management of the administrator, to achieve the purpose for which the administration order was made. If granting leave to a lessor of land or the hirer of goods (a "lessor") to exercise his proprietary rights and repossess his land or goods is unlikely to impede the achievement of that purpose, leave should normally be given.

(3) In other cases when a lessor seeks possession the court has to carry out a balancing exercise, balancing the legitimate interests of the lessor and the legitimate interests of the other creditors of the company: see *per* Peter Gibson J. in *Royal Trust Bank v. Buchler* [1989] B.C.L.C. 130, 135. The metaphor employed here, for want of a better, is that of scales and weights. Lord Wilberforce adverted to the limitations of this metaphor in *Science Research Council v. Nassé* [1980] A.C. 1028, 1067. It must be kept in mind that the exercise under section 11 is not a mechanical one; each case calls for an exercise in judicial judgment, in which the court seeks to give effect to the purpose of the statutory provisions, having regard to the parties' interests and all the circumstances of the case. As already noted, the purpose of the prohibition is to enable or assist the company to achieve the object for which the administration order was made. The purpose of the power to give leave is to enable the court to relax the prohibition where it would be inequitable for the prohibition to apply.

(4) In carrying out the balancing exercise great importance, or weight, is normally to be given to the proprietary interests of the lessor. Sir Nicolas Browne-Wilkinson V.-C. observed in *Bristol Airport Plc. v. Powdrill* [1990] Ch. 744, 767D-E that, so far as possible, the administration procedure should not be used to prejudice those who were secured creditors when the administration order was made in lieu of a winding up order. The same is true regarding the proprietary interests of a lessor. The underlying principle here is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise, save to the extent that this may be unavoidable and even then this will usually be acceptable only to a strictly limited extent.

(5) Thus it will normally be a sufficient ground for the grant of leave if significant loss would be caused to the lessor by a refusal. For this purpose loss comprises any kind of financial loss, direct or indirect, including loss *543 by reason of delay, and may extend to loss which is not financial. But if substantially greater loss would be caused to others by the grant of leave, or loss which is out of all proportion to the benefit which leave would confer on the lessor, that may outweigh the loss to the lessor caused by a refusal. Our formulation was criticised in the course of the argument, and we certainly do not claim for it the status of a rule in those terms. At present we say only that it appears to us the nearest we can get to a formulation of what Parliament had in mind.

(6) In assessing these respective losses the court will have regard to matters such as: the financial position of the company, its ability to pay the rental arrears and the continuing rentals, the administrator's proposals, the period for which the administration order has already been in force and is expected to remain in force, the effect on the administration if leave were given, the effect on the applicant if leave were refused, the end result sought to be achieved by the administration, the prospects of that result being achieved, and the history of the administration so far.

(7) In considering these matters it will often be necessary to assess how probable the suggested consequences are. Thus if loss to the applicant is virtually certain if leave is refused, and loss to others a remote possibility if leave is granted, that will be a powerful factor in favour of granting leave.

(8) This is not an exhaustive list. For example, the conduct of the parties may also be a material consideration in a particular case, as it was in the *Bristol Airport* case. There leave was refused on the ground that the applicants had accepted benefits under the administration, and had only sought to enforce their security at a later stage: indeed, they had only acquired their security as a result of the operations of the administrators. It behoves a lessor to make his position clear to the administrator at the outset of the administration and, if it should become necessary, to apply to the court promptly.

(9) The above considerations may be relevant not only to the decision whether leave should be granted or refused, but also to a decision to impose terms if leave is granted.

(10) The above considerations will also apply to a decision on whether to impose terms as a condition for refusing leave. Section 11(3)(c) and (d) makes no provision for terms being imposed if leave is refused, but the court has power to achieve that result. It may do so directly, by giving directions to the administrator: for instance, under section 17, or in response to an application by the administrator under section 14(3), or in exercise of its control over an administrator as an officer of the court. Or it may do so indirectly, by ordering that the applicant shall have leave unless the administrator is prepared to take this or that step in the conduct of the administration. Cases where leave is refused but terms are imposed can be expected to arise frequently.

Exhibit 2

*45 Bank of Tokyo Ltd. v Karoon and Another



Positive/Neutral Judicial Consideration

Court

Court of Appeal (Civil Division)

Judgment Date

24 May 1984

Report Citation

[1986] 3 W.L.R. 414

[1987] A.C. 45



Court of Appeal

Ackner and Robert Goff L.JJ.

1984 April 3, 4, 5; May 24

Injunction—Jurisdiction to grant—Foreign proceedings—Interpleader proceedings to determine ownership of money held by bank in England—Bank's subsidiary in New York providing information concerning claimant and his accounts—Claimant bringing proceedings in New York against subsidiary—Whether bank entitled to injunction to restrain proceedings in New York

APPEAL from Bingham J.

In 1983 Mr. Majid Karoon started proceedings in New York against the Bank of Tokyo Ltd., a Japanese bank carrying on business in London, and also against a wholly-owned subsidiary of that bank, the Bank of Tokyo Trust Co. *46 (B.T.T.C.). The bank applied to the High Court in London for an order preventing Mr. Karoon from continuing that action. On 7 November 1983 Bingham J. refused to order Mr. Karoon to discontinue his action against B.T.T.C. but did order that he be restrained from continuing against the bank.

The bank appealed against that part of the order relating to B.T.T.C. The grounds of their appeal, contained in a notice dated 18 November 1983, were that (1) (i), in relation to Mr. Karoon's claim against B.T.T.C., the judge had failed to give sufficient consideration to the facts that (a) the New York action involved litigation of the matter already ordered to be determined in the trial of an interpleader issue brought by the bank in the High Court regarding the true ownership of the relevant moneys, (b) the continuation of the New York action against B.T.T.C. would mean that the bank, contrary to their position as interpleaders, would acquire an interest in the outcome of the interpleader issue ordered between Mr. Karoon and his Iranian company, Maritime Co. Ltd., (c) Mr. Karoon had made no complaint about the use or proposed use by the bank of the information contained in their affidavit dated 20 May 1980 at any time before the interpleader issue had, with his consent, been ordered, and (d) there was no apparent difference between the laws of New York and England relating to bank confidentiality; (ii) the judge failed to give sufficient weight to the difficulty, inconvenience, undesirability and inappropriateness of entrusting to a foreign court (with or without a jury) rather than to the English court the investigation and determination of, inter alia, (a) whether the order of Robert Goff J. dismissing Mr. Karoon's application made in the course of the interpleader proceedings that no disclosure of the existence of certain sums of money be made, had been caused by the information set out in that affidavit and whether he would have reached a different conclusion if such evidence had not been submitted by the bank, (b) whether, if the interpleader summons had been struck out as regards the relevant sums of money, the bank would have refused payment and defended any claim brought against them by Mr. Karoon for such sums and, if so, what the consequences of such a course of action would have been, (c) other incidental questions of the practice and procedure of the High Court; (iii) the judge should have held that Mr. Karoon's contention that the decision of Robert Goff J. was caused by the information in the affidavit of 20 May 1980 was arguable; (iv) the judge failed to give sufficient consideration or weight to the nature and amount of the damages which might be recoverable by Mr. Karoon if any cause of action against B.T.T.C. was established. (2) The judge should have held that

the prosecution of the New York action should be restrained in its entirety because (i) it involved relitigating matters already determined or in issue in the English proceedings, namely the propriety of the interpleader summons as regards the relevant moneys, and (ii) it represented a sanction on the use by the bank of admissible and pertinent evidence in the English proceedings. (3) The judge should have held that the injustice to the bank in being sued by Mr. Karoon through the medium of the bank's wholly-owned subsidiary and/or that it was unrealistic to distinguish between the bank and B.T.T.C in this regard.

The facts are set out in the judgments of Ackner and Robert Goff L.JJ.

The following cases are referred to in the judgments:

Abidin Daver, The [1984] A.C. 398; [1984] 2 W.L.R. 196; [1984] 1 All E.R. 470, H.L.(E.) .
Armstrong v. Armstrong [1892] P. 98
Atlantic Star, The [1974] A.C. 436; [1973] 2 W.L.R. 795; [1973] 2 All E.R. 175, H.L.(E.) .
Bethell v. Peace (1971) 441 F. 2d 495 *47
Booth v. Leycester (1837) 1 Keen 579
British Airways Board v. Laker Airways Ltd. [1984] Q.B. 142; [1983] 3 W.L.R. 544; [1983] 3 All E.R. 375, C.A. .
Bushby v. Munday (1821) 5 Madd. 297
Carron Iron Co. v. Maclaren (1855) 5 H.L.Cas. 416, H.L.(E.) .
Castanho v. Brown & Root (U.K.) Ltd. [1981] A.C. 557, [1980] 3 W.L.R. 991; [1981] 1 All E.R. 143, H.L.(E.) .
Chapman v. Honig [1963] 2 Q.B. 502; [1963] 3 W.L.R. 19; [1963] 2 All E.R. 513, C.A. .
Christian v. Christian (1897) 67 L.J.P. 18
Cohen v. Rothfield [1919] 1 K.B. 410, C.A. .
Cole v. Cunningham (1890) 133 U.S. 107
Distillers Co. (Biochemicals) Ltd. v. Thompson [1971] A.C. 458; [1971] 2 W.L.R. 441; [1971] 1 All E.R. 694, P.C. .
Distin, In re (1871) 24 L.T. 197
Ellerman Lines Ltd. v. Read [1928] 2 K.B. 144, C.A. .
Enoch and Zaretsky Bock & Co.'s Arbitration, In re [1910] 1 K.B. 327, C.A. .
European Asian Bank A.G. v. Punjab & Sind Bank [1982] 2 Lloyd's Rep. 356, C.A. .
Fallon v. Calvert [1960] 2 Q.B. 201; [1960] 2 W.L.R. 346; [1960] 1 All E.R. 281, C.A. .
Graham v. Maxwell (1849) 1 Mac. & G. 71
Gulf Oil Corporation v. Gilbert (1947) 330 U.S. 501
Hyman v. Helm (1883) 24 Ch.D. 531, C.A. .
Laker Airways Ltd. v. Sabena, Belgian World Airlines (1984) 731 F. 2d 909
Lett v. Lett [1906] 1 I.R. 618
McHenry v. Lewis (1882) 22 Ch.D. 397, C.A. .
MacShannon v. Rockware Glass Ltd. [1978] A.C. 795, [1978] 2 W.L.R. 362; [1978] 1 All E.R. 625, H.L.(E.) .
Moore v. Moore (1896) 12 T.L.R. 221, C.A. .
North Carolina Estate Co. Ltd., In re (1889) 5 T.L.R. 328
Peruvian Guano Co. v. Bockwoldt (1883) 23 Ch.D. 225, C.A. .
Piper Aircraft Co. v. Reyno (1981) 454 U.S. 235
St. Pierre v. South American Stores (Gath & Chaves) Ltd. [1936] 1 K.B. 382, C.A. .
Sim v. Robinow (1892) 19 R. 665
Smith Kline & French Laboratories Ltd. v. Bloch [1983] 1 W.L.R. 730; [1983] 2 All E.R. 72, C.A. .
Société du Gaz de Paris v. Société Anonyme de Navigation "Les Armateurs Français", 1926 S.C.(H.L.) 13, H.L.(Sc.) .
Tournier v. National Provincial and Union Bank of England [1924] 1 K.B. 461, C.A. .
Trapp v. Mackie [1979] 1 W.L.R. 377; [1979] 1 All E.R. 489, H.L.(Sc.) .
Trendtex Trading Corporation v. Credit Suisse [1980] Q.B. 629; [1980] 3 W.L.R. 367; [1980] 3 All E.R. 721, C.A., [1982] A.C. 679; [1981] 3 W.L.R. 766; [1981] 3 All E.R. 520, H.L.(E.) .
Tropaioforos, The (No. 2) [1962] 1 Lloyd's Rep. 410

The following additional cases were cited in argument:

Cook v. Swinfen [1967] 1 W.L.R. 457; [1967] 1 All E.R. 299, C.A. .
Hadmor Productions Ltd. v. Hamilton [1983] 1 A.C. 191; [1982] 2 W.L.R. 322; [1982] I.C.R. 114; [1982] 1 All E.R. 1042, H.L.(E.) . *48
Metall und Rohstoff A.G. v. A C L I Metals (London) Ltd. [1984] 1 Lloyd's Rep. 598, C.A. .

Portarlington v. Soulby (1834) 3 My. & K. 104
X.A.G. v. A Bank [1983] 2 All E.R. 464; [1983] 2 Lloyd's Rep. 535

Leonard Hoffmann Q.C. and D. T. Donaldson for the Bank.

N. A. Strauss for Mr. Karoon.

Cur. adv. vult.

24 May 1984. The following judgments were read

ACKNER L.J.

The respondent, Mr. Karoon, is neither a national of, nor resident in, this country. He is an Iranian citizen who left Iran at the time of the revolution in November 1979 and is now living in France. The Bank of Tokyo Trust Co. ("B.T.T.C") is a New York corporation which is a wholly owned subsidiary of the Bank of Tokyo Ltd. ("B.T."), the appellants, a Japanese bank carrying on business in London.

On 7 November 1983 Bingham J. refused to grant an injunction restraining Mr. Karoon from taking any further steps in an action that he had begun in New York against B.T.T.C., or commencing or prosecuting any other proceedings relating to the same subject matter before any other court than the English High Court. It is against this refusal that B.T. now appeals. He did however order that Mr. Karoon be restrained from continuing the proceedings against B.T., who had been joined as co-defendants with B.T.T.C. Against this decision there is no cross-appeal.

The circumstances out of which his claim in the New York action arose can be shortly stated. Although Mr. Karoon and his wife and children were able to leave Iran, the rest of Mr. Karoon's family and his wife's family are still in Iran and he has fears for their safety. From 1961 onwards he was the chief operating officer of an Iranian company called Maritime Co. Ltd. ("Maritime") in which he owned nearly all the shares. Maritime carried on a shipping business. For some years prior to his departure from Iran he maintained a personal bank account with B.T.T.C. He also maintained both a personal and a company account with B.T. Following his departure from Iran, Mr. Karoon transferred approximately \$685,000 from his personal account with B.T.T.C. to his personal account with B.T. He also instructed B.T. to transfer all money from the company account to his personal account.

In February 1980 B.T. received a letter from Maritime in Iran to advise them that on 3 February 1980 Mr. Karoon had been sentenced in absentia to 10 years' imprisonment and that his property and the company's had been taken over by the Government of Iran. B.T. was asked to transfer all balances to Iran. B.T. responded to the effect that all the company's accounts had been closed prior to their receipt of this letter, upon the instructions of the accounts sole signatory (Mr. Karoon), and that under English law it would be a breach of confidence to make any disclosure regarding a customer's personal affairs without his prior authorisation. They also advised Mr. Karoon of their receipt of this letter and their response. He thereupon instructed them to transfer funds they were holding to an account which he maintained with another bank. B.T. was concerned with its position. If it did not carry out his instructions, it might be liable to him. On the other hand, if it did carry out his instructions, it might be liable to those now in charge of Maritime. Accordingly, on 21 March 1980, B.T. issued an interpleader summons to determine whether the money which it held was payable to Mr. Karoon or to Maritime.

*49

On 15 April 1980 Mr. Karoon issued a summons to strike out the interpleader proceedings under [R.S.C., Ord. 18, r. 19](#) . In his affidavit he swore, inter alia:

"On 3 December 1979 I remitted U.S. \$685,800 of my own money from my account at the bank's branch in New York to the bank ... These moneys had not originated from the company."

He explained how they were placed on deposit and that on 27 December 1979 there was due to him U.S. \$689,421.88. He contended that Maritime could have no arguable claim to these moneys, even if proceedings were appropriate in respect of the English funds. He also expressed concern that, if the Iran Government knew about the funds in London, his relations would be used as a lever to force him to remit the money to Iran.

In reply to this affidavit, Mr. Saunders, an officer of B.T., swore another affidavit in which he said, in paragraphs 1 to 4 as follows:

"1. Inquiries have been made of the Bank of Tokyo Trust Co., New York in respect of a remittance in the sum of U.S. \$685,800 credited to the first defendant's external savings account number 61817-3 on 5 December 1979 in order to establish the source of the said money.

"2. I am informed and verily believe that the said sum was made up from two fixed deposits ((a) and (b) respectively) which were automatically renewable every three months and which had been pre-matured and credited to the first defendant's New York checking account (number 121-004-775) in order to cover the said payment. Fixed deposit (a) was valued at U.S. \$183,797.83 and (b) at U.S. \$497,803.98.

"3. Fixed deposit (a) was opened on 14 December 1978 with a transfer of U.S. \$170,000 from a savings account maintained by the first defendant, which account was opened on 5 April 1976 with initial funds of U.S. \$425,000 by means of a transfer from the first defendant's checking account number 121-004-775. I am informed that the sum of U.S. \$511,000 had been credited to the said checking account on 30 December 1975 by order of Fairfield International Ltd. of 227 Park Avenue, New York. Prior to 14 December 1978, the said savings account had been credited with U.S. \$115,200, being the proceeds of a cheque drawn on Midland Marine Bank, New York by order of Mowbrays Tug and Barge Sales Corporation.

"4. Fixed deposit (b) was opened on 23 April 1979 with a transfer of U.S. \$473,000 from the said savings account maintained by the first defendant. The account had been credited on 11 April with the proceeds of a cheque for U.S. \$32,569.75 drawn on Wells Fargo Bank New York by order of Utah House Fire Insurance Co. and on 23 April with the proceeds of a cheque for U.S. \$441,992.01 drawn on Chase Manhattan Bank by order of Adams and Porter Inc."

The affidavit was never served on Maritime, who were at that time not party to the proceedings to strike out. The application, which was heard by Robert Goff J. failed. A note of his judgment was before Bingham J., and the relevant part of the proceedings before him was quoted by the judge:

"There were certain accounts in the name of Majid Karoon and certain accounts in the name of Maritime. Certain moneys were transferred from New York which Majid Karoon says are his. There has been an amalgamation of accounts carried out in accordance with instructions given on 24 December 1979 and 20 February 1980. ... Finally I am asked to look at the evidence to find that a substantial part of the moneys must belong to Majid Karoon. I am invited to look at the letter and to find that it makes no claim on Majid Karoon's assets. The difficulty is that I am faced with one party's evidence. The bank is in the middle and can only act fairly, *50 which it cannot do not knowing the full facts. It would be quite wrong for me to pre-empt the situation on one party's evidence - especially having regard to the history which shows that Majid Karoon has not sought to keep his own and Maritime's moneys separate. No accurate assumptions on a split can be made.

"It seems to me that the workers council letter is written in such English as the bank has reasonable grounds to assume that a claim may be pressed not only against Maritime's accounts but also against Majid Karoon's accounts in so far as the money is in origin Maritime's money which he has transferred into his own account. He may have acted in breach of his obligations to the company. In my judgment there are reasonable grounds that the bank may be sued for not only Maritime's money but also that money held by Majid Karoon. The bank was fully entitled to interplead. I cannot accede to the application. To interplead was a natural reflex of the bank."

On 4 March 1983 an interpleader issue was eventually ordered. The order was by consent, no attempt being made to limit the order to the English as opposed to the American moneys. It read as follows:

"1. The plaintiffs [B.T.] be forthwith discharged from any liability to either of the defendants in respect of any moneys the subject matter of these proceedings and that no action be brought in respect thereof against the plaintiffs by either of the defendants, including an action by the first defendants acting in the name of the second defendants.

"2. The plaintiffs do pay the moneys the subject matter of these proceedings after deduction of their usual banking charges into court as and when each of the current special deposits matures and that the moneys presently held on call be paid together with the first special deposit money on maturity thereof and that meanwhile the plaintiffs hold the said moneys to the direction of the court."

The complaint of the New York proceedings is based upon B.T.T.C.'s voluntary disclosure to B.T. of information relating to his account in New York. This disclosure is alleged to have been a breach of its contractual duty of confidence to Mr. Karoon, to have violated Mr. Karoon's "right of privacy" and made in conspiracy with B.T. to injure Mr. Karoon. A total of U.S. \$4,000,000.00 damages is claimed, U.S. \$1,000,000.00 as punitive damages for the breach of the "right of privacy" and the conspiracy, additional to the U.S. \$1,000,000.00 claimed for "special damage" for each of the three causes of action.

Before Bingham J., Mr. Hoffmann submitted that the New York proceedings would cause injustice to his clients for a number of reasons, which the judge summarised under five headings. The first two can be taken together, it being submitted: whatever the prospects of success, the New York action is an attempt to penalise B.T. for availing itself of the interpleader procedure in England and complying with the [Rules of the Supreme Court](#). The New York action would involve relitigating a matter already litigated in England, i.e. whether an interpleader should have been ordered in respect of moneys remitted from the United States. As such, the action is vexatious and oppressive. It is in truth doubly vexatious and oppressive because it has no reasonable prospect of success, since Mr. Karoon will be quite unable to show that he has suffered any damage, because Robert Goff J. would have made the self same order if B.T. had not relied upon the information provided to it by B.T.T.C.

Mr. Hoffmann's three further points submitted to the judge can be stated as one proposition, namely, that an English court is the forum conveniens because it can without difficulty resolve what duty of confidence, if any, was owed the *51 New York bank in these circumstances to its client Mr. Karoon. [Tournier v. National Provincial and Union Bank of England \[1924\] 1 K.B. 461](#), is the source of the law in both jurisdictions. By contrast, a New York judge would be faced with difficult questions concerning the duty of an English litigant in an English interpleader. Moreover, if Mr. Karoon were able to establish that he would have succeeded in striking out the interpleader proceedings had not B.T.T.C. provided the information to B.T., he would still have to establish, in order to claim damages, that the money in London belonged to him and that issue has to be decided in London. Mr. Karoon, moreover, has no legitimate judicial advantages in proceeding in New York.

Before Bingham J. no submission appears to have been made to the judge that a different approach might be justified to the New York action, according to whether one was considering the position of B.T.T.C. or the position of B.T. Neither party asked the judge to differentiate between B.T. and B.T.T.C. in any order he made. However, in his judgment, viewing the two companies as two separate legal entities, Bingham J. concluded that they should be treated separately. In regard to the New York action, in so far as it related to B.T.T.C., he said:

"It is an action brought in New York against a bank incorporated and carrying on business there. Mr. Karoon, an Iranian citizen resident in France, had an account with that bank. Although Mr. Karoon has advanced three causes of action against B.T.T.C. (breach of confidence, invasion of privacy and conspiracy) it seems plain that his central complaint against B.T.T.C. arises from its voluntary disclosure to B.T. of information relating to his account. Whether this disclosure involved a breach of contractual duty, or of Mr. Karoon's right to privacy, on the part of B.T.T.C. must be determined according to the law of New York. Whether B.T.T.C. was guilty of an actionable conspiracy may also fall to be decided under that law, although this cause of action appears to be something of a makeweight. The disclosure by B.T. to the English court forms no part of Mr. Karoon's cause of action against B.T.T.C. That disclosure does have a significant bearing on Mr. Karoon's ability to prove actual damage flowing from the disclosure, since he could show none if Robert Goff J. would have made the same order even without the information concerning Mr. Karoon's American transactions in Mr. Saunders' affidavit. To that extent the action does involve inquiry into what Robert Goff J. would have done on different evidence, an inquiry which would be best carried out by this court. It is, however, an inquiry which a New York court could doubtless undertake and resolve. Mr. Karoon may have a cause of action for invasion of privacy available to him in New York which is not available here. It would certainly appear that his chances of obtaining substantial damages on a punitive or exemplary basis are better there. His ability to sue in New York on a contingency fee basis may not be a juridical advantage ([Smith Kline & French Laboratories Ltd. v. Bloch \[1983\] 1 W.L.R. 730](#), 747H) and is, in my view counterbalanced by B.T.T.C.'s inability to recover costs if successful, but is certainly not an argument against allowing the New York action to proceed against B.T.T.C. Overall, I do not regard an injunction as appropriate to restrain the action insofar as it lies against B.T.T.C. If the action were to proceed, B.T.T.C. might, of course, win or lose; and if it lost the damages might be large, or nominal, or even non-existent. But all these seem to me to be matters best entertained and resolved in the New York court which would be applying its own law to events very largely occurring within its own jurisdiction."

*52

In reaching his decision relative to B.T.T.C., Bingham J. was applying the principles to which he made specific reference, as laid down or reflected in the decisions of *The Atlantic Star* [1974] A.C. 436, *MacShannon v. Rockware Glass Ltd.* [1978] A.C. 795, *Castanho v. Brown & Root (U.K.) Ltd.* [1981] A.C. 557 and *Trendtex Trading Corporation v. Credit Suisse* [1980] Q.B. 629. These principles were not in dispute between the parties.

He then turned to the New York action against B.T., commenting that the claim assumed a somewhat different aspect. He said:

"The crux of Mr. Karoon's complaint against B.T. is that it acted unlawfully in seeking information from B.T.T.C. The allegation is made that B.T. gratuitously revealed this information, but Mr. Strauss accepted that the revelation was not gratuitous and acknowledged the difficulty of maintaining that B.T. had no interest in revealing that information. B.T. is also accused of conspiracy and inducement of breach of contract by B.T.T.C. but these complaints arise out of the same factual premise, namely, the request for information made by B.T. to B.T.T.C. This was a request made by B.T. in the context of its role as a party seeking to interplead under R.S.C., Ord. 17. In his original affidavit, Mr. Saunders had made no overt reference to these moneys transferred by B.T.T.C. to B.T. Mr. Karoon raised a clear issue concerning them in his affidavit of 25 April. B.T. had either to let the matter (and the moneys) go, with the risk that it might later be held accountable for the moneys, or make such inquiries as it could (or, if it had already made inquiry, inform the court of the result).

"Leaving entirely on one side the question whether, on information being requested, B.T.T.C. should, as a matter of New York law, have complied with the request, I think that two significant questions of English law arise in respect of B.T.'s conduct: whether it was reasonable and proper for B.T., in seeking to protect its own interests, to request information from B.T.T.C.; and whether, in pursuance of its duty as a party applying to interplead it was proper for B.T. to seek to lay before the court all evidence within its power relevant to the application. This is a lis between a bank carrying on business in London and a London customer of that bank arising out of English interpleader proceedings to which both were party. Moreover, it directly touches on a matter with which this court must be very closely concerned, the proper conduct of a party to English interpleader proceedings. I should not and do not form or express any opinion whether B.T.'s conduct was proper or improper. That is not an issue before me. I am, however, of the opinion that B.T. would be exposed to the risk of real injustice if the propriety of its conduct were to be judged in any court other than that in which the interpleader proceedings took place. It furthermore appears to me that England is in every way a more appropriate forum than New York for trial of the issues between Mr. Karoon and B.T. and that Mr. Karoon would lose no legitimate juridical or personal advantage by suing here. The New York forum would afford him no additional cause of action and the chance of an improved measure of damage would be problematical. These considerations are, however, in my judgment, of less weight in this than the usual case because the overriding consideration of what justice demands points strongly towards restraint of Mr. Karoon's action against B.T. in New York. If B.T. were the only New York defendant, I would, even bearing in mind the need for great caution in restraining prosecution of a foreign action, think it right to grant an injunction."

The difficulty which then faced Bingham J. was the combination in one set of New York proceedings of claims against B.T.T.C., which he was not willing to *53 restrain, and claims against B.T., which he was. He concluded that it would not be right to grant an excessive injunction, which would be the case if he restrained the prosecution of an action which he regarded as properly brought against B.T.T.C. in New York, nor would it be right to expose B.T. to an unacceptable risk of injustice. He therefore made no mandatory order that Mr. Karoon discontinue his New York proceedings, but he continued the negative injunction made ex parte on 13 September 1983, restraining Mr. Karoon from taking any further steps in the New York action so far as it related to B.T. Mr. Karoon thus remained free to prosecute the New York action against B.T.T.C. Mr. Strauss on behalf of Mr. Karoon is content with that position because B.T. is not a necessary party to the New York action. Mr. Karoon can obtain all the remedies to which he is entitled with the New York action limited to B.T.T.C.

Before us Mr. Hoffmann has stressed the distinction between his two lines of argument, and reinforced the distinction by reference to the recent decision of the United States Court of Appeal for the District of Columbia Circuit, in *Laker Airways Ltd. v. Sabena, Belgian World Airlines* (1984) 731 F. 2d 909. His first line of argument is that, as a matter of English public policy, the claims in New York should not be allowed to be brought at all. Citing the American *Laker* case:

"Courts have a duty to protect their legitimately conferred jurisdiction to the extent necessary to provide full justice to litigants. ... a court may freely protect the integrity of its judgments by preventing their evasion through vexatious or oppressive relitigation" (per Judge Wilkey, at pp. 928-929),

he maintained: (1) that there is "an overriding public policy" that a litigant should be able to take all proper steps to put relevant evidence before the court;(2) that it is in the public interest that there should be finality in litigation, and since Mr. Karoon had not objected to Mr. Saunders' affidavit being put before Robert Goff J., he should not now be allowed to bring an action for damages allegedly arising from the use of that affidavit.

As regards the latter point, Mr. Hoffmann expressly accepted that any objection by Mr. Karoon would have been doomed to failure and in such circumstances it seems to me plain that Mr. Karoon cannot be blamed for having failed to take what is accepted would have been futile action.

Thus, Mr. Hoffmann's first and main criticism of Bingham J.'s decision is that he treated the case as being an ordinary case of competition between two jurisdictions where the question was which was the most appropriate forum.

It is however quite fundamental to Mr. Hoffmann's submission, (and he readily accepts this) that the public policy on which he relied requires the court to overlook the corporate distinctions in law between B.T. and B.T.T.C. While accepting that B.T. and B.T.T.C. are separate legal entities, Mr. Hoffmann contends that from a practical point of view it makes no difference whether B.T.T.C. was a branch of B.T. or a subsidiary. He argues that if one looks at the substance of the matter, B.T. are being sued in New York on account of the evidence which they gave in their own defence in proceedings brought against them by Mr. Karoon in London. The protection of B.T.'s own interests required the giving of this information and accordingly B.T., which must in practice be treated as having this information in their possession, was not in breach of its implied obligation of secrecy: see *Tournier v. National Provincial and Union Bank of England [1924] 1 K.B. 461* .

The reality of the matter is that B.T.T.C. is not a branch of B.T. That is not the way in which B.T. has chosen to organise its business as a bank. Of course, B.T. is entitled to take all proper steps to obtain evidence to resist Mr. Karoon's application to strike out the interpleader summons, but the issue remains, were *54 these steps proper ones? If, as Mr. Karoon maintains, B.T.T.C. owed him a duty of confidence and was therefore not entitled to communicate to another separate legal entity any information concerning his account with them without his approval, then B.T.T.C. was in breach of its duty and it would follow that B.T. induced a breach of contract. Mr. Hoffmann accepted that if B.T.T.C. was not a subsidiary of B.T. but was another bank, then Mr. Karoon would certainly have a cause of action, although he maintained his contention that his damages would be purely nominal.

I can see no valid basis, and certainly no authority was provided to us by Mr. Hoffmann, for the contention that we must ignore the separate legal existence of B.T.T.C. Once the corporate distinction in law between B.T. and B.T.T.C. has to be recognised, the foundation of Mr. Hoffmann's submission that there is an English rule of public policy which requires that this action should not be allowed to be brought disappears. There is an arguable case that B.T.T.C., a separate juridical entity, owing Mr. Karoon an obligation of secrecy, broke that obligation when, without his consent, they revealed to B.T. the material referred to above concerning his account in New York.

In his reply, Mr. Hoffmann formulated a further issue of public policy, namely, that damages cannot be recovered, other than nominal damages for breach of contract, as a result of there being introduced into litigation in England relevant and admissible evidence, even though such evidence has been improperly obtained. He submitted that as a matter of public policy it is so essential to the administration of justice that all relevant and admissible evidence is placed before the courts that, even though such evidence may have been provided in breach of a contract not to divulge such material and damage can be established to have resulted from this wrongful disclosure, the plaintiff's remedy is limited to nominal damages for breach of contract, and he has no remedy against the person who wrongfully induced the breach of contract.

Mr. Hoffmann was at pains to make quite clear that he was not limiting this rule of public policy to the case of a plaintiff who had wrongfully concealed evidence or sought to mislead the court, and had ultimately failed in his claim because evidence improperly obtained had ultimately been put before the court. That would merely be an example of the well-established principle, *ex turpi causa non oritur actio*. Mr. Hoffmann was unable to produce any authority in support of the existence of this rule of public policy and it became apparent in the course of his submissions that it would not be difficult to imagine examples where such a rule would operate contrary to accepted notions of justice and fairness. Moreover, it is of the very essence of our adversarial system that the court decides the dispute on the material placed before the court, it being for the parties and not for the court to decide of what that material should consist. Hence the well-established principle that in civil litigation the judge is not entitled, without the consent of the parties, to call a witness, although he may have every reason to believe that such a

witness might well enable him the better to reach a just decision: see *In re Enoch and Zaretsky Bock & Co.'s Arbitration* [1910] 1 K.B. 327 and *Fallon v. Calvert* [1960] 2 Q.B. 201 .

I am therefore far from satisfied that such a wide principle of public policy exists. But, even were it to exist, it would not justify the striking out of the action. Ex hypothesi, the plaintiff would have a good cause of action for breach of contract, and the fact that his damages might well be nominal still entitles him to bring his action. He might well be content with a declaration which established that the defendant broke some important duty of secrecy and was therefore not to be trusted. Accordingly, this rule of English public policy, were it to exist, cannot support Mr. Hoffmann's contention that the action against B.T.T.C. should never have been brought and therefore that the proceedings *55 should be stopped in limine. It would merely preclude the right to recover more than nominal damages.

The action brought by Mr. Karoon against B.T.T.C. is in every sense an American action. The contract upon which the contractual claim is based was made in New York with a New York corporation. The proper law of that contract is American law and if according to American law a breach of that contract took place when B.T.T.C. divulged information to B.T., then the breach of that contract took place in New York. So far as the tort of conspiracy is concerned, the alleged conspirator who is being sued is a New York corporation and for an alleged conspiracy that took place in New York, because it was there that both the agreement and the overt acts in pursuance of that conspiracy were made and carried out. It will be for American law to determine whether the tort of conspiracy was committed and for this decision the New York court is the natural forum: see *Distillers Co. (Biochemicals) Ltd. v. Thompson* [1971] A.C. 458 . Further, the alleged invasion of privacy occurred in New York. It is a cause of action as yet unknown to English law and will have to be determined in accordance with New York law. In the result New York law will be the proper law for the determination of whether or not there has been a breach of contract and whether or not B.T.T.C. has committed the two torts alleged. New York law will also be the *lex fori*. In such circumstances it seems to me to be irrelevant that in England, assuming Mr. Hoffmann's submission to be correct, Mr. Karoon would have recovered only nominal damages for breach of contract.

As regards Mr. Hoffmann's second line of attack, he ultimately conceded that, if the corporate distinctions in law must not be overlooked and B.T.T.C. must be treated as a separate legal entity (as is indeed my view), then New York is the natural forum for the reasons to which I have recently referred. In such circumstances there is no need to consider the balance of legitimate juridical advantages. However, were we obliged to consider that matter, I do not think that Mr. Hoffmann would have seriously contended that the balance was other than in favour of the action remaining in New York. Mr. Karoon alleges on affidavit that as a result of B.T. successfully interpleading he has no funds to support his litigation. However, in America he can bring his claim because of the contingency fee system. The *Smith Kline case* [1983] 1 W.L.R. 730 was a decision on its own very special facts, where the Court of Appeal was clearly of the view that the plaintiff, who had legal aid in England, was abusing the contingency fee system in order to bring proceedings in America against the American parent corporation, against which he had no real cause of action. His cause of action, if any, lay against the English subsidiary and his conduct in bringing the American proceedings was clearly vexatious. Thus, in that case it was not a *legitimate* juridical advantage. Moreover, were Mr. Karoon to bring proceedings in England, he would inevitably be met with a claim for security of costs, being resident out of the jurisdiction, and this he could not, or would have great difficulty in meeting. He is of course faced with no such problems in the United States. It is common ground that under New York law he may well have a claim for exemplary damages. Although this is certainly not accepted by B.T., Mr. Karoon might, under New York law, be able to recover exemplary damages, even though he only obtained nominal damages for the alleged breach of contract and/or no actual damage for the torts of invasion of privacy or conspiracy.

In the end there is left only one unusual feature which will face the New York court. It will have to decide whether the provision by B.T.T.C. to B.T. of the information which B.T. subsequently put before the court in fact resulted in Mr. Karoon losing any real chance of either striking out the interpleader summons or obtaining summary relief under R.S.C., Ord. 17, r. 5 - in short, *56 what probably would have happened in England if B.T.T.C. had not made the information available to B.T. Although this is an unusual inquiry for a New York court to make, it will, if and when required, be provided with expert evidence as to English law and procedure and should ultimately have no difficulty in resolving this issue.

I would accordingly dismiss this appeal.

ROBERT GOFF L.J.

The judge was faced with the following situation. The Bank of Tokyo Ltd., the appellant before this court ("B.T."), had commenced interpleader proceedings in this country. It had done so because there were moneys credited to accounts at its London branch to which competing claims were being made - on the one hand by an Iranian company, Maritime Co. Ltd. ("Maritime"), through a workers' council in Iran which, following the revolution in that country, appeared to have gained control of Maritime; and, on the other hand, by an Iranian gentleman, Mr. Karoon, the respondent before this court, who formerly controlled Maritime but who has, since the revolution in Iran, left that country and taken up residence in France. The interpleader proceedings have been complicated by the fact that Mr. Karoon, fearing that disclosure to Maritime of the existence of certain of these moneys might have an adverse effect on his family in Iran, sought to persuade the English court that no such disclosure should be allowed. That attempt has in fact failed, because disclosure was necessary to enable the interpleader issue to be tried. However, one of the steps which Mr. Karoon at one time took was to ask the English court to strike out the interpleader proceedings under R.S.C., Ord. 18, r. 19, his submission being that certain moneys which had been transferred to B.T.'s London branch from Mr. Karoon's personal account with the Bank of Tokyo Trust Co., the New York subsidiary of B.T. ("B.T.T.C."), were his own and were moreover moneys to which Maritime could have no arguable claim, so that they should not be the subject of the interpleader proceedings.

The commercial judge (who, it so happens, was myself) dismissed that application. A note of the judgment is before this court and shows that the basis of the decision was that the court considered that, having regard in particular to a letter emanating from the workers' council, B.T. had reasonable grounds for thinking that it might be sued by Maritime not only in respect of moneys of Maritime but also in respect of moneys of Mr. Karoon on the ground that they had emanated from Maritime, and that it would be wrong for the court to preempt the situation on the evidence of one party only. At all events, for the purposes of his application to strike out, Mr. Karoon swore an affidavit concerning the moneys which had been transferred from B.T.T.C., stating that those moneys had not originated from Maritime. As a result, B.T. made inquiries of B.T.T.C. about those moneys. B.T.T.C. then supplied information about the moneys to B.T., some of which was embodied in an affidavit sworn by Mr. Saunders of B.T. for the purpose of laying the information before the commercial judge when he dealt with Mr. Karoon's application to strike out.

Mr. Karoon has taken objection to his bankers in New York, B.T.T.C., supplying this information to B.T., and indeed he has objected to B.T. seeking to obtain the information from B.T.T.C. So, on 7 July 1983, he commenced proceedings in New York against both B.T. and B.T.T.C. In those proceedings he alleged (1) breach by B.T.T.C. of its contractual duty of confidence to him, in revealing the information to B.T.; (2) breach of contract by B.T. in obtaining the information; (3) violation by B.T.T.C. of Mr. Karoon's right of privacy; (4) conspiracy by B.T. and B.T.T.C.; and (5) that B.T. wrongfully induced B.T.T.C. to break its contract with Mr. Karoon.

On its application before the judge, B.T. asked for an order directing Mr. Karoon to discontinue the action in New York against B.T. and B.T.T.C. *57 and/or an injunction restraining Mr. Karoon from taking any further steps in the New York action or "commencing or pursuing any other proceedings relating to the same subject matter before any other court than this Honourable Court." The judge declined to make a mandatory order, but he maintained an injunction (which had earlier been granted *ex parte*) in terms expressly limited to the New York proceedings against B.T. The effect was that Mr. Karoon was free to prosecute his New York action against B.T.T.C. but not against B.T.

[His Lordship referred to the judgment of Bingham J. below, cited passages set out in the judgment of Ackner L.J., ante, pp. 49G - 50C, 51C, D-H, 52B-G and continued:] B.T. has appealed to this court against the judge's decision, in so far as he failed to restrain Mr. Karoon from pursuing the New York action as against B.T.T.C. There is no cross-appeal by Mr. Karoon. This is for the simple practical reason that Mr. Karoon's New York action can continue just as well against B.T.T.C. alone. However, in so far as it may be necessary for the purposes of resisting B.T.'s appeal, Mr. Karoon has by his respondent's notice taken the point that the judge was wrong to continue the injunction restraining Mr. Karoon from further prosecuting the New York action against B.T.

Before the judge, Mr. Hoffmann for B.T. had argued that the New York proceedings would cause injustice to his clients for a number of reasons, viz: (1) the New York action was vexatious because (a) it was an attempt to penalise B.T. for availing itself of the interpleader proceedings in England, (b) it would involve re-litigating the question (already litigated here) whether an interpleader issue should have been ordered, and (c) it had no reasonable prospect of success; and (2) any action should be tried in England because (a) the interpleader proceedings were already here, (b) an English court could, without difficulty, resolve what duty of confidence is owed by a New York bank to its client, whereas a New York judge would be faced with difficult questions regarding English interpleader proceedings, (c) the question of ownership of the moneys had to be decided first anyway, and (d) the availability of a contingency fee to Mr. Karoon could not, on the authorities, be regarded as a juridical advantage to him. Before this court, however, Mr. Hoffmann's argument was somewhat different. The reason for the development of his argument

was the intervening decision of the U.S. Court of Appeals in *Laker Airways Ltd. v. Sabena, Belgian World Airlines* (1984) 731 F. 2d 909 which was only decided on 6 March 1984 and so was not available to Bingham J. in the present case. Mr. Hoffmann drew on the analysis of Judge Wilkey, who delivered the majority judgment in that case, and urged this court to do likewise in considering the problem in the present case. In order to place Mr. Hoffmann's submissions in their context, it will be necessary briefly to summarise the relevant principles stated by Judge Wilkey. This is no easy task. The judgment is substantial both in content and in length. I have studied it with interest and, indeed, respect.

Laker Airways Ltd. v. Sabena, Belgian World Airlines is concerned with the unhappy clash of jurisdiction which has occurred between courts in this country and courts in the United States, following upon the commencement by the liquidators of Laker of antitrust proceedings in the United States against a number of international airlines, alleging that their combined activities were the cause of Laker's downfall. Among the airlines so sued were two British airlines, British Airways and British Caledonian. Following the making of an order by the Secretary of State for Trade and Industry in this country (acting under powers conferred on him by Act of Parliament) which had the effect of prohibiting the two British airlines from complying with "United States antitrust measures," the Court of Appeal in this country granted an injunction restraining Laker from taking any steps against British Airways and British Caledonian in the United States action: *British Airways Board v. Laker Airways Ltd.* [1984] Q.B. 142. Meanwhile, in the United States Laker obtained temporary restraining *58 orders from the District Court restraining other airlines from instituting in the courts in this country similar proceedings for an injunction. Two of those airlines, KLM and Sabena, challenged the District Court's preliminary injunction on appeal to the Court of Appeals. The Court of Appeals, by a majority, declined to overturn the injunction so granted.

In the course of his judgment Judge Wilkey analysed in depth the applicable principles of law. I am only concerned, for present purposes, with his consideration of the propriety of what he called "the antisuit injunction." I shall summarise the principles stated by him as briefly as I can, though I realise that so brief a summary cannot do justice to his reasoning.

(1) He observed, 731 F. 2d 909, 926-927, that the sufficiency of jurisdictional contacts with both the United States and England resulted in concurrent jurisdiction to prescribe.

"However, the fundamental corollary to concurrent jurisdiction must ordinarily be respected: parallel proceedings on the same in personam claim should ordinarily be allowed to proceed simultaneously, at least until a judgment is reached in one which can be pled as res judicata in the other ... For this reason, injunctions restraining litigants from proceeding in courts of independent countries are rarely issued," though "A second reason cautioning against exercise of the power is avoiding the impedance of the foreign jurisdiction."

(2) "There are no precise rules governing the appropriateness of antisuit injunctions. The equitable circumstances surrounding each request for an injunction must be carefully examined to determine whether, in the light of the principles outlined above, the injunction is required to prevent an irreparable miscarriage of justice."

However, (3) injunctions are most often necessary (a) to protect the jurisdiction of the enjoining court, or (b) to prevent the litigant's evasion of the important public policies of the forum.

(4) With regard to (3) (a) above, viz. protection of the jurisdiction of enjoining court, a distinction was drawn between cases where the enjoining court has proceeded to judgment on the merits, and cases where an injunction is requested to protect the court's jurisdiction before a judgment has been reached. In the former case there is little interference with the rule favouring parallel proceedings in matters subject to concurrent jurisdiction: so a court may protect the integrity of its judgments by preventing their evasion through vexatious or oppressive relitigation: see, e.g., *Bethell v. Peace* (1971) 441 F. 2d 495. In the latter case the factors which might support the issue of an injunction do not usually outweigh the importance of permitting foreign concurrent actions; and the policies underlying the rule permitting parallel proceedings in concurrent in personam actions are more properly considered in a motion for dismissal for forum non conveniens. Even so, there must be circumstances in which an antisuit injunction is necessary to conserve the court's ability to reach a judgment, and the District Court's injunction was proper on that basis.

(5) With regard to (3) (b) above, viz. preventing the litigant's evasion of the important public policies of the forum, an antisuit injunction will issue to preclude participation in the litigation only when the strongest equitable factors favour its use. Among the authorities cited by Judge Wilkey where such an injunction has issued was *Cole v. Cunningham* (1890) 133 U.S. 107, a case concerned with protecting the exercise of bankruptcy jurisdiction. Judge Wilkey further considered that the District Court's

injunction properly prevented KLM and Sabena from attempting to escape the application of the United States antitrust laws to the conduct of business in the United States.

Mr. Hoffmann urged us to adopt a similar approach in the present case to that adopted by Judge Wilkey in his analysis, and in particular to distinguish, on *59 the basis of both English and United States authorities, the two groups of cases where injunctions may be granted, viz. to protect the jurisdiction of the court and to prevent the litigant's evasion of the important public policies of the forum. The present case before us fell, submitted Mr. Hoffmann, within these principles. He asked us to approach the case by considering first whether, if B.T. in London and B.T.T.C. in New York had been a single entity and all relevant events had happened in England, proceedings in this country similar to those commenced by Mr. Karoon in New York would have been struck out as an abuse of process. He submitted that they would, because such proceedings would have infringed both the public interest in making available all relevant evidence for the court and the public interest that there should be finality in litigation. That being so, he submitted that it made no difference that Mr. Karoon had commenced his proceedings not in this country but in New York, because the English court, in protecting the integrity of its own jurisdiction, should not allow a litigant, subject to its jurisdiction, to bring such an action in a foreign jurisdiction. Furthermore, he submitted, having regard to the basis of the jurisdiction, the court should not be deflected from giving effect to its public policy by the fact that B.T. and B.T.T.C. are different legal entities; otherwise it would be sacrificing substance to form.

As an alternative to this main line of argument, Mr. Hoffmann invoked the principles enunciated by the House of Lords in recent cases concerned with alternative forums, viz. *MacShannon v. Rockware Glass Ltd.* [1978] A.C. 795 and *Castanho v. Brown & Root (U.K.) Ltd.* [1981] A.C. 557, and submitted that, on the "critical equation" referred to in those cases, the balance pointed towards requiring Mr. Karoon to litigate in England.

In considering Mr. Hoffmann's submissions, I recognise that it is not merely legitimate but desirable that courts in this country should pay due regard to developments in sister common law jurisdictions, notably the United States; this is especially desirable when the court is concerned with principles of law affecting the relationship between our two jurisdictions and when we are presented with an analysis as profound as that of Judge Wilkey in *Laker Airways Ltd. v. Sabena, Belgian World Airlines*, 731 F. 2d 909. Even so, we have to proceed with due caution. Not only do we have to operate within the confines of the doctrine of precedent in this country, but we have to bear in mind that the development of the relevant principles of law in our two countries may not be identical. Frequently, however, under the influence of history and of practical pressures to which both jurisdictions are subject, it transpires that there have taken place in our two jurisdictions parallel developments which, though neither simultaneous nor identical, reveal a very similar trend.

This is just what we find in the case of what American lawyers call "antisuit injunctions." At bottom, the fundamental principles appear to have developed along similar lines. Thus, the jurisdiction is very wide, being available for exercise whenever justice demands the grant of an injunction. Again, the English court does not attempt to restrain the foreign court, but operates in personam, restraining a party from instituting or prosecuting the suit in the foreign jurisdiction; though an injunction will only be granted to restrain a person who is regarded as being properly amenable to the jurisdiction of the English courts. Furthermore, it has been repeatedly stated that the jurisdiction must be exercised with extreme caution, indeed sparingly: this is partly because concurrent proceedings in different jurisdictions are tolerated, but also because of a desire to avoid conflict with other jurisdictions. For it is accepted, as is indeed obvious, that courts of two different jurisdictions, one in this country and one in a foreign country, can have jurisdiction over the same dispute. It is not prima facie vexatious for the same plaintiff to commence two actions relating to the same subject matter, one in England and one abroad; but the court may be *60 less ready to tolerate suits in two jurisdictions in the case of actions in rem than it is in the case of actions in personam. All these principles are well-established, and indeed non-controversial, and appear to be common to both the English and the United States jurisdictions.

But the jurisdiction to grant such an injunction has only rarely been exercised in this country. The earliest cases in which the jurisdiction was established do not necessarily provide authoritative examples of its exercise today, indeed one of them (*Bushby v. Munday* (1821) 5 Madd. 297) was later to be described by Lord Brougham as going to the "very verge of the law" (see *Carron Iron Co. v. Maclaren* (1855) 5 H.L.Cas. 416, 446). In the course of the 19th century, there developed a line of cases in which assets were being administered by the English court, and one interested person sought to gain an advantage over other interested persons by prosecuting proceedings in a foreign country where part of the assets were situated. In such cases, for example, where a person sought in this way to gain the benefit of foreign assets of an estate after a decree of administration (see, e.g., *Graham v. Maxwell* (1849) 1 Mac. & G. 71), or of a bankrupt after his petition in bankruptcy (see, e.g., *In re Distin* (1871) 24 L.T. 157), or of a company after winding up proceedings had been commenced (see, e.g. *In re North Carolina Estate Co. Ltd.* (1889) 5 T.L.R. 328), such a person has been restrained by injunction from pursuing foreign proceedings, but only if he were a domiciled Englishman or otherwise amenable to the jurisdiction of the English court. In the later 19th century,

however, following the decisions of the Court of Appeal in *McHenry v. Lewis* (1882) 22 Ch.D. 397 and *Peruvian Guano Co. v. Bockwoldt* (1883) 23 Ch.D. 225, it became accepted that, at least in the case of actions in personam, concurrent proceedings by the same party in this country and abroad were not prima facie vexatious, and the proceedings abroad should not therefore be restrained. It was for the party seeking an injunction to prove that the proceedings abroad were vexatious, for that purpose, he had generally to show that the plaintiff in the foreign court could not obtain an advantage from the foreign procedure which he could not obtain in the English court: see in particular *Hyam v. Helm* (1883) 24 Ch.D. 531, and *Cohen v. Rothfield* [1919] 1 K.B. 410. That criterion was very rarely fulfilled: for examples where it was fulfilled see *Armstrong v. Armstrong* [1892] P. 98, *Moore v. Moore* (1896) 12 T.L.R. 221 and *Christian v. Christian* (1897) 67 L.J.P. 18.

Injunctions have however also been granted to restrain proceedings brought in breach of contract (see *Lett v. Lett* [1906] 1 I.R. 618 and *The Tropaioforos* (No. 2) [1962] 1 Lloyd's Rep. 410), and to restrain enforcement of a judgment obtained fraudulently: see *Ellerman Lines Ltd. v. Read* [1928] 2 K.B. 144. Putting aside these latter cases, however, and without attempting to cut down the breadth of the jurisdiction, the golden thread running through the rare cases where an injunction has been granted appears to have been the protection of the jurisdiction; an injunction has been granted where it was considered necessary and proper for the protection of the exercise of the jurisdiction of the English court. This can be said not only of cases where assets were being administered by the English court but also of cases where proceedings abroad were restrained as vexatious, for a party who attempts to reap the benefit of proceeding vexatiously is interfering with the proper course of administration of justice here: for example, see *Armstrong v. Armstrong* [1892] P. 98, 101, per Jeune J. But there was this difference between these two groups of cases: that, whereas in the latter group the foreign proceedings were regarded as vexatious because the plaintiff could derive no advantage from them, in the former group he was restrained precisely because he might gain an advantage from the foreign proceedings.

Now at one time it was thought that the requirement that proceedings must be vexatious was applicable, not only to the exercise of the court's jurisdiction *61 to restrain a party from instituting or prosecuting foreign proceedings, but also to the exercise of the court's jurisdiction to stay proceedings commenced in this country: see again *McHenry v. Lewis*, 22 Ch.D. 397 and *Peruvian Guano Co. v. Bockwoldt*, 23 Ch.D. 225. A stay would only be granted if the continuance of the action in this country would be oppressive or vexatious to the defendant or otherwise an abuse of the process of the court, and if a stay would not cause an injustice to the plaintiff: see *St. Pierre v. South American Stores (Gath & Chaves) Ltd.* [1936] 1 K.B. 382, per Greer L.J., at p. 392 and per Scott L.J., at p. 398. Again, these criteria were rarely fulfilled. However, in *The Atlantic Star* [1974] A.C. 436, the House of Lords recognised that this very rare restrictive criterion for staying proceedings in this country was too nationalistic: Lord Reid referred to it, at p. 453, as a "rather insular doctrine." In that case the court relaxed the criteria of "oppression" and "vexation." Four years later, in *MacShannon v. Rockware Glass Ltd.* [1978] A.C. 795, the House of Lords relaxed the criteria still further, abandoning altogether the criteria of "oppression" and "vexation," and adopting a principle which is now accepted to be indistinguishable from the principle of forum non conveniens as accepted in Scottish law: see *The Abidin Daver* [1984] A.C. 398. A parallel development has taken place in the United States: see *Gulf Oil Corporation v. Gilbert* (1947) 330 U.S. 501 and *Piper Aircraft Co. v. Reyno* (1981) 454 U.S. 235.

On these authorities it may be observed that there are strong similarities in the way in which the law on this topic has developed in both countries. However, in 1981 there occurred a development in this country which has sharply differentiated the two jurisdictions. In *Castanho v. Brown & Root (U.K.) Ltd.* [1981] A.C. 557, Lord Scarman (who delivered a speech with which the remainder of the House of Lords agreed) treated the criteria applicable to the exercise of the court's discretion to impose a stay or grant an injunction as identical. He said, at p. 574: "It is unnecessary now to examine the earlier case law. The principle is the same whether the remedy sought is a stay of English proceedings or a restraint upon foreign proceedings." After referring to *The Atlantic Star* [1974] A.C. 436, he quoted a passage from Lord Diplock's speech in *MacShannon's case* [1978] A.C. 795, 812, as embodying his distillation of principle in the case of a stay, which reads:

"In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the court that there is another forum to whose jurisdiction he is amenable in which justice can be done between the parties at substantially less inconvenience or expense, and (b) the stay must not deprive the plaintiff of a legitimate personal or juridical advantage which would be available to him if he invoked the jurisdiction of the English court."

Lord Scarman then said, at p. 575:

"Transposed into the context of the present case, this formulation means that to justify the grant of an injunction the defendants must show: (a) that the English court is a forum to whose jurisdiction they are amenable in which justice can be

done at substantially less inconvenience and expense *and* (b) the injunction must not deprive the plaintiff of a legitimate personal or juridical advantage which would be available to him if he invoked the American jurisdiction. The formula is not, however, to be construed as a statute. No time should be spent in speculating as to what is meant by 'legitimate.' It, like the whole of the context, is but a guide to solving in the particular circumstances of the case the 'critical equation' between advantage to the plaintiff and disadvantage to the defendants."

Lord Scarman did not apparently consider it necessary to give reasons for his opinion that the principle is the same whether the remedy sought is a stay of *62 English proceedings or a restraint upon foreign proceedings, and that it was therefore unnecessary, having regard to the decisions of the House of Lords in *The Atlantic Star* [1974] A.C. 436 and *MacShannon's case* [1978] A.C. 795, both of which related only to a stay of English proceedings, to examine earlier case law on *restraint of foreign* proceedings. As I have recorded, it is now recognised that the principle applicable in the case of a stay of foreign proceedings is indistinguishable from the Scottish principle of *forum non conveniens*. This Latin tag is, like many others, misleading: proceedings in the English forum are stayed not because *England* is an *inconvenient* forum, but because there is another clearly more *appropriate* forum *abroad*. The classic statement of principle is to be found in the judgment of Lord Kinnear in *Sim v. Robinow* (1892) 19 R. 665, 668, when, after stating that the court would not refuse to exercise its jurisdiction "upon the ground of a mere balance of convenience and inconvenience," he said that

"the plea can never be sustained unless the court is satisfied that there is some other tribunal, having competent jurisdiction, in which the case may be tried more suitably for the interests of all the parties and for the ends of justice."

A similar principle was adopted by Lord Sumner in *Société du Gaz de Paris v. Société Anonyme de Navigation "Les Armateurs Français"*, 1926 S.C. (H.L.) 13, 22, when he said that the object was to find "that forum which was the more suitable for the ends of justice."

It follows that the policy underlying the principle of *forum non conveniens* is a policy of declining to exercise jurisdiction where there is another clearly more appropriate forum; though, if in such circumstances trial in England would offer the plaintiff a real advantage, a balance must be struck and the court must decide in its discretion whether justice requires a stay. This policy, avowedly less nationalistic than the old principle of vexation or oppression as applied in the past in cases of stay of proceedings, is one which is given effect to, on an application by the defendant, by a court of the forum in which there have been commenced proceedings over which the court has jurisdiction. It is a self-denying ordinance. The principle (derived from the speeches of their Lordships in *MacShannon's case* [1978] A.C. 795) was so interpreted and applied in *Trendtex Trading Corporation v. Credit Suisse* [1980] Q.B. 629, with the approval of the House of Lords in that case, Lord Roskill [1982] A.C. 679, 705, describing the judge's approach as "entirely correct in principle." Furthermore, the exercise of the judge's discretion, so approved, in that case involved the granting of a stay, although the plaintiff was thereby deprived of a most valuable juridical advantage in this country, viz. discovery of documents in accordance with English rules of procedure. It appears therefore that a juridical advantage of the plaintiff in this country will not necessarily be decisive. (That this is indeed so can be illustrated by the often-quoted example of a road accident involving two motorists in a foreign country, both being resident nationals of that country: one seizes the opportunity given by the casual presence of the other in this country to serve proceedings upon him here, with the aim of recovering the higher damages available in the English courts. The English court would surely order a stay of proceedings on the application of the defendant, though the plaintiff's whole purpose in proceeding here was to obtain the juridical advantage of higher damages.) The decision of the House of Lords in the *Trendtex* case was followed by the Court of Appeal in *European Asian Bank A.G. v. Punjab & Sind Bank* [1982] 2 Lloyd's Rep. 356. The principles in these two cases, derived from all the speeches of the House of Lords in *MacShannon's case* [1978] A.C. 795 and approved by the House of Lords in the *Trendtex case* [1982] A.C. 679, are, I understand, regularly followed in the Commercial Court, where cases of this kind tend to arise for decision.

In *Castanho v. Brown & Root (U.K.) Ltd.* [1981] A.C. 557 Lord Scarman has taken the principle of *forum non conveniens* as developed in relation to a stay of English proceedings where it was expressly developed in order to adopt a less nationalistic approach, i.e. to render the English courts *less* tenacious of proceedings started within its jurisdiction, and has applied it *inversely* in cases of restraint by the English courts of foreign proceedings. The effect would appear to be, not only that in cases of restraint of foreign proceedings the very restrictive principle of protection of the English jurisdiction has been abandoned, but also that the English court will now be more free to grant injunctions restraining foreign proceedings than it was in the past under the old case law. We should perhaps not be surprised to discover that the approach of Lord Scarman in *Castanho* is different from the approach of courts in the United States. There, as here, the grant of stay of proceedings depends upon the application of

the principle of forum non conveniens: see, e.g., *Piper Aircraft Co. v. Reyno*, 454 U.S. 235 . But the grant of an injunction restraining foreign proceedings depends upon the twin principles of protection of the jurisdiction of the court of the forum, and of preventing evasion of important public policies of the forum; and in each case the principles have been stated and applied in restrictive terms. So cases of stay of proceedings and of restraint of foreign proceedings are regarded as being founded upon different principles. Furthermore, as appears from Judge Wilkey's opinion in *Laker Airways Ltd. v. Sabena, Belgian World Airlines*, 731 F.2d 909 , in the United States it is considered more appropriate, where there is a clash of jurisdiction, for a stay of proceedings to be considered by the court seised of the matter rather than for a court to establish its own forum as the more appropriate forum by granting an injunction restraining proceedings in a foreign court.

Given the present divergence between the principles applicable in our two countries, it is, I fear, very difficult for this court to respond to Mr. Hoffmann's submission that we should proceed on the basis of Judge Wilkey's analysis in *Laker Airways Ltd. v. Sabena, Belgian World Airlines*. I can only console myself with the reflection that in any event Mr. Hoffmann's submission appears to me to involve an illegitimate extension, in at least two respects, of the principles as stated by Judge Wilkey, and indeed of the principle as developed in the long line of English cases before *Castanho v. Brown & Root (U.K.) Ltd.* [1981] A.C. 557 .

I first address myself to the public interest that there should be finality in litigation. Such a public interest no doubt exists. Moreover, authorities can be found, both in this country and in the United States, in which courts have gone so far as to grant injunctions restraining persons properly amenable to their jurisdiction from relitigating abroad matters which have already been the subject of a judgment of the court of the forum. For an English example, see the old case of *Booth v. Leycester* (1837) 1 Keen 579 ; and for an American example, see *Bethell v. Peace*, 441 F. 2d 495 . *The Tropaioforos* (No. 2) [1962] 1 Lloyd's Rep. 410 could perhaps also be treated as falling under this head, though it contained the exceptional feature that the litigant sought to be restrained had entered into an agreement with all underwriters to be bound by the outcome of the proceedings, thereby providing a contractual basis for the grant of the injunction. However, I do not regard the present case as falling under this head of public policy. In the New York proceedings, Mr. Karoon is not, as I understand it, seeking to relitigate a matter which has been the subject of a judgment in this country. He is seeking rather to obtain redress from a bank in New York in respect of disclosure of confidential information by that bank in New York. I cannot see that the mere fact that Mr. Karoon had an opportunity, *64 which he did not take, to object to Mr. Saunders' affidavit being put in evidence on the striking out application in London has any effect on the situation. The simple fact is that the cause of action alleged by Mr. Karoon against B.T.T.C. has not been the subject of a judgment in this country. I can therefore see no basis for the submission of Mr. Hoffmann.

Mr. Hoffmann's second submission however raises more difficult problems. He asserted a public interest in making available all relevant evidence for the court. This public interest was, he submitted, exemplified by the rule that statements in affidavits are absolutely privileged in defamation proceedings (see *Trapp v. Mackie* [1979] 1 W.L.R. 377 , 378-379, per Lord Diplock), and by the rule that victimisation of a witness on account of evidence he has given is a contempt of court: see *Chapman v. Honig* [1963] 2 Q.B. 502 , 512, per Lord Denning M.R. His original submission before us was that, on this principle B.T. could not be sued for adducing evidence in the interpleader summons. However, in the course of argument he recognised that the gravamen of his submission lay in a litigant seeking to recover damages in respect of the disclosure of material evidence in proceedings, when the only damage suffered was (it was submitted) a failure to achieve a result which would have been achieved had the material evidence not been disclosed. As a matter of public policy such damages should not, submitted Mr. Hoffmann be recoverable in law.

Now this submission does indeed raise novel and difficult problems. It cannot be said to be entirely without substance, but it was not founded on any authority cited to us, either from this country or from the United States. Furthermore, if any such policy exists, as proposed by Mr. Hoffmann, it may be given effect to as part of the lex fori; and it does not necessarily follow that a court of this country would give effect to it by an injunction restraining proceedings in another jurisdiction. We have also always to bear in mind the restraint we must impose upon ourselves before taking any steps which might bear upon the exercise by the courts of another country of its own jurisdiction. However, in the present case, I must desist from exploring this interesting and novel proposition, because there is in my judgment a fatal obstacle to Mr. Hoffmann's argument. This is that the evidence in question was adduced in a court of this country not by B.T.T.C., but by B.T. The proceedings which Mr. Hoffmann is asking this court to restrain are proceedings by Mr. Karoon against B.T.T.C., in respect of their having divulged confidential information not to the English court but to B.T. I cannot for my part see that the public policy now asserted by Mr. Hoffmann should (assuming that it exists) provide any ground for restraining those proceedings. Mr. Hoffmann suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary company in this context; economically, he said, they were one. But we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be bridged. For this reason, I should in any event have dismissed this argument.

I turn then to consider Mr. Hoffmann's alternative submission which was founded upon Lord Scarman's speech in *Castanho v. Brown & Root (U.K) Ltd. [1981] A.C. 557*. This was to the effect that, applying the principles in *MacShannon's case [1978] A.C. 795*, the balance points towards requiring Mr. Karoon to litigate in England. He relied in this connection in particular upon the following factors: proceedings were already on foot in London between B.T. and Mr. Karoon; the issue whether Mr. Karoon was entitled to the moneys in question will in any event have to be decided in the interpleader issue in London; there is no dispute of fact over what happened in New York, and the principles of law on bankers' confidentiality in New York and London are substantially the same; the critical question whether the provision of information *65 caused any loss to Mr. Karoon would be better decided here; and Mr. Karoon has no legitimate juridical advantage in New York.

I have to confess that I find the consequences of this argument to be startling. There is no pending litigation in this country between Mr. Karoon and B.T.T.C.; that of itself would render any order by the English court restraining the action in New York a remarkable restraint upon the prosecution of proceedings in that state. Even if England were to be regarded by the English court as a clearly more appropriate forum, or the natural forum, for the trial of the action, I feel the gravest reservations about an English court granting an injunction restraining Mr. Karoon from proceeding in New York rather than allowing a court of that state, being the forum having jurisdiction where an action has already been commenced, making its own decision whether England is the more appropriate forum and whether it should in the circumstances grant a stay of proceedings. But in any event I am not prepared to hold that England is a clearly more appropriate forum for the trial of the action between Mr. Karoon and B.T.T.C. The cause of action arose in New York. One of the parties is a New York corporation: the other is an Iranian citizen resident in France. The applicable law is the law of the State of New York; and, even if New York law on breach of confidence by a banker shares a common origin with our own law on the subject, I am not prepared to assume in the present case that they are identical, and in any event there are other legal issues in the case (for example, a claim to penal damages). Taking into account the factors relied upon by Mr. Hoffmann, I cannot see that they displace the strong connection with the New York jurisdiction. That being so, on the principles expounded by the House of Lords in *MacShannon's case [1978] A.C. 795*, as interpreted with the approval of the House of Lords in the *Trendtex case [1982] A.C. 679*, there can be no basis, upon the inverse application of the principle of forum non conveniens, to grant an injunction restraining Mr. Karoon from continuing with his proceedings against B.T.T.C. in New York.

For these reasons, I would dismiss the appeal.

Representation

Solicitors: Herbert Smith & Co. ; Baker & McKenzie .

*Appeal dismissed with costs. Leave to appeal refused. Injunctions to continue over hearing of petition for leave to appeal.
([Reported by MRS. HARRIET DUTTON, Barrister-at-Law])*

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Exhibit 3

*744 Bristol Airport Plc. and Another v Powdrill and Others



Positive/Neutral Judicial Consideration

Court

Court of Appeal (Civil Division)

Judgment Date

21 December 1989

Report Citation

[1990] 2 W.L.R. 1362

[1990] Ch. 744



Court of Appeal

Sir Nicolas Browne-Wilkinson V.-C. , Woolf and Staughton L.JJ.

1989 Nov. 21, 22, 23; 1989 Dec. 21

Company—Administration order—Steps to enforce security—Insolvent airline operating under administration order—Detention of aircraft because of default in payment of airport charges—Whether leased aircraft "property"—Whether exercise of statutory right of detention "steps . . . taken to enforce . . . security" against property of airline—Whether leave of court required— Civil Aviation Act 1982 (c. 16), s. 88(1) — Insolvency Act 1986 (c. 45), s. 11(3)

^{1 2} An insolvent charter airline had debts totalling £11m. The applicants, airport operators, were two of its unsecured creditors who together were owed over £1.5m. On 7 August 1989 the airline was placed under an administration order made pursuant to [section 8 of the Insolvency Act 1986](#) and the airline continued trading. All airport charges incurred during the course of the administration were met. In October 1989 the administrators announced that there was a prospect of selling the airline on terms beneficial to its creditors and called a creditors' meeting for 3 November. At a meeting on 30 October between representatives of four airport operators including the two applicants it was agreed that none of them would exercise any power of detention over aircraft, which were operated by the airline under leasing agreements, until after the creditors meeting. However, on 2 November the first applicant applied for ex parte leave to detain two of the airline's aircraft under [section 88 of the Civil Aviation Act 1982](#) . Leave was granted pending an inter partes hearing, although one of the aircraft was then allowed to go. On hearing of the first applicant's action, the second applicant, without obtaining leave of the court, parked a lorry loaded with concrete in front of an aircraft operated by the airline and served the captain with a lien notice. Later the same day the second applicant obtained ex parte leave for the detention. The creditors' meeting took place the following day and both applicants attended. The sale of the airline was approved without dissent but was incapable of performance while the aircraft remained detained. On 6 November Harman J. heard both applications for leave to detain and held that the applicants required leave of the court under [section 11\(3\) of the Insolvency Act 1986](#) before exercising their right under [section 88 of the Civil Aviation Act 1982](#) , to detain an aircraft being operated by an airline in administration and, in the exercise of his discretion, refused to grant such leave.

On appeal by the applicants: -

Held, dismissing the appeal,

(1) that, although the airline held the aircraft under the terms of leases, the aircraft were "property" of the airline within the meaning of [section 436 of the Insolvency Act 1986](#) and the statutory right to detain aircraft *745 conferred on airport authorities by section 88 of the Civil Aviation Act 1982 came within the definition of "lien or other security" in [section 248 of the Act of 1986](#); that the applicants by detaining the aircraft not only had created security for their debts but in asserting their right to retain the aircraft were taking steps to enforce that security and, therefore, [section 11\(3\)\(c\) of the Act of 1986](#) applied and they required either the administrator's consent or leave of the court before they exercised their right of retention of property belonging to the airline, which was the subject of an administration order (post, pp. 759C-D, H - 760E, 761B-C, 762H - 763A, D-E, H - 764C, E-H, 767F-G).

(2) That the applicants, having taken substantial benefits from the administration of the airline, should not be permitted to enforce a right which was inconsistent with the administration order and thereby obtain greater rights from the making of the order than they would have done if the airline had gone into liquidation; that, in the circumstances, the judge had rightly exercised his discretion by refusing to grant the applicants leave to enforce their right to detain the aircraft (post, pp. 767B-E, 771G-H).

Per Sir Nicolas Browne-Wilkinson V.-C. and Woolf L.J. Until a lien holder makes an unqualified refusal to hand over the goods, he has not taken steps to enforce the security for the purposes of [section 11\(3\)\(c\) of the Act of 1986](#). On detaining an aircraft an aerodrome authority is not to be treated as taking steps to enforce the statutory right to detain if an application for leave is promptly made to the court and the authority makes it clear that it is only preventing the removal of the aircraft pending determination of the question whether it is entitled to exercise its statutory right to detain (post, pp. 764E-H, 769D-H).

Decision of Harman J. affirmed.

The following cases are referred to in the judgments:

Air Ecosse Ltd. v. Civil Aviation Authority (1987) 3 B.C.C. 492 , Ct. of Session
Channel Airways Ltd. v. Manchester Corporation [1974] 1 Lloyd's Rep. 456
Havelet Leasing Ltd. v. Cardiff-Wales Airport Ltd. (unreported), 29 June 1988, Phillips J.
Quazi v. Quazi [1980] A.C. 744; [1979] 3 W.L.R. 833; [1979] 3 All E.R. 897, H.L.(E.) .
Queen of the South, The [1968] P. 449; [1968] 2 W.L.R. 973; [1968] 1 All E.R. 1163
Smith (A Bankrupt), In re, Ex parte Braintree District Council [1990] 2 A.C. 215; [1989] 3 W.L.R. 1317; [1989] 3 All E.R. 897, H.L.(E.) .

The following additional cases were cited in argument:

Abbott v. Philbin [1960] Ch. 27; [1959] 3 W.L.R. 739; [1959] 3 All E.R. 590 , C.A.; [1961] A.C. 352; [1960] 3 W.L.R. 255; [1960] 2 All E.R. 763, H.L.(E.) .
Air Canada v. Secretary of State for Trade [1981] 3 All E.R. 336
Ally, The [1952] 2 Lloyd's Rep. 427
Ayerst v. C. & K. (Construction) Ltd. [1976] A.C. 167; [1975] 3 W.L.R. 16; [1975] 2 All E.R. 537, H.L.(E.) .
Cohen v. Lester (J.) Ltd. [1939] 1 K.B. 504; [1938] 4 All E.R. 188 *746
Debtor (No. 1 of 1987), In re A [1989] 1 W.L.R. 271; [1989] 2 All E.R. 46, C.A. .
Felixstowe Dock & Railway Co. v. United States Lines Inc. [1989] Q.B. 360; [1989] 2 W.L.R. 109; [1988] 2 All E.R. 77
Harris Simons Construction Ltd., In re [1989] 1 W.L.R. 368
Herbert Berry Associates Ltd., In re [1977] 1 W.L.R. 1437; [1978] 1 All E.R. 161, H.L.(E.) .
Kasumu v. Baba-Egbe [1956] A.C. 539; [1956] 3 W.L.R. 575; [1956] 3 All E.R. 266, P.C. .
Mayfair Trading Co. Pty. Ltd. v. Dreyer [1959] A.L.R. 104
Mitchener v. Equitable Investment Co. Ltd. [1938] 2 K.B. 559
Roberts Petroleum Ltd. v. Bernard Kenny Ltd. [1983] 2 A.C. 192; [1983] 2 W.L.R. 305; [1983] 1 All E.R. 564, H.L.(E.) .
Royal Trust Bank v. Buchler [1989] B.C.L.C. 130
Standard Austria S.H. 1964, *The* [1965] 2 Lloyd's Rep. 189
Western Bank Ltd. v. Schindler [1977] Ch. 1; [1976] 3 W.L.R. 341; [1976] 2 All E.R. 393, C.A. .

APPEAL from Harman J.

On 2 November 1989 the first applicant, Bristol Airport Plc., obtained ex parte leave from Harman J. to detain, under [section 88 of the Civil Aviation Act 1982](#), two aircraft operated by Paramount Airways Ltd., a company operating under an administration order made pursuant to [section 8 of the Insolvency Act 1986](#). One of the aircraft was allowed to fly to Australia but the other remained at the airport. Later the same day the second applicant, Birmingham International Airport Plc., also obtained ex parte leave, from Hodgson J., to detain an aircraft operated by Paramount. An inter partes hearing of both applications was heard on 6 November 1989 by Harman J. The respondents were: (1) Roger Arthur Powdrill and Joseph Beaumont Atkinson, the administrators of Paramount, (2) Irish Aerospace Leasing Ltd., the lessor of the detained aircraft and (3) Air 2000 Ltd., the creditor who petitioned for the administration order. Harman J. held that the applicants required leave of the court under [section 11](#) of the Act of 1986 before they could exercise their right of detention and in the exercise of his discretion refused to grant such leave.

By notices of appeal dated 14 November 1989 the applicants appealed on the grounds that the judge was wrong (1) in holding that the exercise by the applicants of their right of detention under section 88 of the Act of 1982 necessarily involved the taking of possession of the aircraft; (2) in holding that the detention of aircraft operated by Paramount constituted "other proceedings . . . commenced . . . against the above named company or its property" within [section 11\(3\)\(d\)](#) of the Act of 1986; (3) in holding that the detention of aircraft operated by Paramount constituted a "distress levied against the company or its property" within section 11(3)(d); (4) in holding that an aircraft was the property of Paramount when Paramount's only interest in the aircraft was under a lease; (5) in holding that the applicants were not entitled to be treated as secured creditors, with a statutory right of detention and/or a contractual lien; (6) in failing to give sufficient weight to the applicants' rights pursuant to section 88 of the Act of 1988; (7) in failing to give sufficient weight to the terms of the contracts entered into between the *747 applicants and the administrators on behalf of Paramount; (8) in failing to give sufficient weight to the fact that if the applicants were denied leave the aircraft would leave their aerodrome and the applicants would lose their remedy against the second respondents and the owners of the aircraft; and (9) in holding that during an administration a creditor was not entitled to rest on his lien or security.

On 20 November the third respondents issued a respondent's notice contending that the judgment should be affirmed on the grounds that when the applicants' detention of the aircraft began, Paramount had ceased to manage them and had thus ceased to be their operators within the meaning of the Act of 1982 and accordingly the applicants' rights to detain aircraft under section 88 of the Act of 1982 in respect of airport charges owed to them by Paramount were confined to arrest of an aircraft in respect of which such charges had been incurred and the applicant had adduced no evidence to that effect.

The facts are stated in the judgment of Sir Nicolas Browne-Wilkinson V.-C.

Gavin Lightman Q.C. and *Simon Mortimore* for both applicants, the airports. The case turned essentially upon the interaction of [section 88 of the Civil Aviation Act 1982](#) and section 11(3)(d) of the Insolvency Act 1986. Section 88 was very far reaching but the interest of an aerodrome was precarious in that it only subsisted as long as an aircraft was at the aerodrome.

Under section 88 the airport's power to detain arose when there was a default in the payment of airport charges incurred in respect of an aircraft at the aerodrome. In order that the power of detention could be exercised, the aircraft had to be on the aerodrome on which those charges had been incurred. If the power of detention was exercised it had to be by some overt act and there had to be a manifest intention to detain: see *The Queen of the South [1968] P. 449* and *Havelet Leasing Ltd. v. Cardiff-Wales Airport Ltd* (unreported), 29 June 1988.

The first issue was whether security only came into being when the power of detention was exercised or whether there was security, under the section, as soon as the aircraft landed at the airport. It was the case for the airports that the security did not crystallise until it was exercised.

In *Channel Airways Ltd. v. Manchester Corporation [1974] 1 Lloyd's Rep. 456* it was held that rights under a similar statute were not an ordinary lien but a statutory right of detention.

Section 88 conferred upon airports a right to detain aircraft which operated in rem so that it bound owners, mortgagees and purchasers and the holders of charges over the aircraft. Clear statutory wording would be required to cut down the airports' statutory right to detain. The exercise of the right to detain did not necessarily involve the taking of possession of the aircraft. The aircraft could remain in the hangar of the operator but it could not leave the aerodrome. The exercise of the right to detain would provide a defence to a claim against the airport for wrongful detention of the aircraft or for breach of a contractual obligation to allow the aircraft to take off. The moment an aircraft operated by a person in default landed at the relevant aerodrome, the *748 right to detain could be exercised. The exercise of the right crystallised the security.

The statute gave airports a right to detain if the operator was in default, because it recognised that airports were particularly vulnerable to bad debts and that the most effective means whereby an airport could secure payment was through detention of aircraft.

The Insolvency Act 1986 was not intended to cut down the provisions of the Civil Aviation Act 1982. Section 88 conferred on airports a power of detention outside the ambit of section 11 of the Insolvency Act. The power and rights conferred did not constitute a security within the meaning of [sections 11 or 248](#) of the Act of 1986. They were sui generis and not to be treated as cut down by the language of that Act.

Alternatively, if the power or rights arising did constitute such security there was still nothing in section 11 which inhibited the exercise of the power of detention. Leave of the court was not required otherwise the rights would be precarious and dependent upon the intervention of the courts. Also, the operator would have an opportunity to remove the aircraft before an order could be obtained.

The power and rights arising under [section 88](#) of the Act of 1982 did not constitute a security over the property of the operator and therefore [section 11\(3\)\(c\)](#) of the Act of 1986 had no application. Alternatively, if the exercise of the power did constitute a security the exercise of the power was not the enforcement of the security but its constitution or perfection. Either the exercise of the right constituted the security or the statutory power was itself the security and security was acquired on touchdown.

Once security was constituted steps could not be taken to enforce it without leave of the court. However, there was a world of difference between "perfecting or crystallising" and "taking steps to enforce" and between "protecting" and "enforcing" a security: see *Western Bank Ltd. v. Schindler* [1977] Ch. 1 .

The critical words in section 11(3)(d) were "no other proceedings may be commenced." The word "other" recognised that certain court "proceedings" were barred under subsection (c). The logical meaning of "other proceedings" was judicial or quasi judicial proceedings. Even if it was wider than that it was certainly narrower than "acts" and there was no reason why mere "detention" should constitute a "proceeding" against the company or its property: see *Abbott v. Philbin* [1960] Ch. 27 ; *Quazi v. Quazi* [1980] A.C. 744 ; *Air Ecosse Ltd. v. Civil Aviation Authority* (1987) 3 B.C.C. 492 .

Distress involved taking into possession the personal chattels of another and was to be distinguished from detention which did not imply a taking into possession. The airports merely detained the aircraft and did not exercise distress.

The detained aircraft were not the "property" of the operators as defined by [section 436](#) of the Act of 1986 because the operators leased the aircraft. It was not intended that the act should afford protection to owners of property who were not the subject of administration orders.

If leave to detain was required it was accepted that a sufficient case had to be made out before leave would be granted: see *Royal Trust Bank v. Buchler* [1989] B.C.L.C. 130 . In refusing to grant such leave the judge failed to take into account three critical factors: (1) The statutory right arose in the course of the conduct of the company by the administrator; (2) the contracts between the company in administration and the airports made express provision for a contractual lien and; (3) refusal of leave operates to defeat any rights against the aircraft owner as well as the operator.

Michael Crystal Q.C. an Mark Phillips for the first respondents. It was fundamental to appreciate the sea change in philosophy which the Insolvency Act 1986 represented in providing for the rehabilitation of individual and corporate debtors short of a formal regime of bankruptcy. There were no direct statutory precursors and it was undesirable to look back into history more than was necessary in attempting to ascertain the effects of administration. On the similar approach in bankruptcy: see *In re A Debtor (No. 1 of 1987)* [1989] 1 W.L.R. 271 .

The court could only make an administration order if it was satisfied that a company was or was likely to become insolvent and considered that there was a real prospect that making an order would achieve one or more of the four purposes specified in [section 8\(3\)](#) of the Act: see *In re Harris Simons Construction Ltd.* [1989] 1 W.L.R. 368 . In essence the question for the court was whether the making of an administration order offered the best prospect for preserving the company's future and maximising the realisation of the company's assets for the benefit of its creditors.

It was an essential part of the scheme for administration that the management of the business of the company by the administrator should be free from interference. This was as essential to the philosophy of administration as was the *pari passu* rule in winding up: see *Ayerst v. C. & K. (Construction) Ltd.* [1976] A.C. 167 and *Roberts Petroleum Ltd. v. Bernard Kenny Ltd.* [1983] 2 A.C. 192 .

Assistance could be gained from considering Chapter 11 of the United States Bankruptcy Code , a convenient summary of which could be found in an extract from the opinion of an American bankruptcy judge quoted by Hirst J. in *Felixstowe Dock & Railway Co. v. United States Lines Inc.* [1989] Q.B. 360 .

Section 88 of the Civil Aviation Act 1982 gave a designated airport a right over an aircraft operated by a person who became indebted to the airport in respect of airport charges. Such right gave an interest in somebody else's property, the aircraft, which could be enforced by detention, retention and, where appropriate, sale. An aircraft could only be detained where it was at the airport in question.

The obtaining of physical dominion over the relevant aircraft was not the creation of security but a step taken in the enforcement of security which had already been conferred by the statute and created by the debtor's default in making payment of the relevant airport charges.

The exercise of such a right by an overt act of detention was, therefore, a "step taken to enforce a security" within the meaning of section 11(3)(c) of the Insolvency Act 1986 .

Provided detention was not simply the creation of security but included an element of enforcement it was covered by section 11(3)(c). *750 It was only if the act of detention were regarded as creating the security that it would fall outside section 11(3)(c).

It was inappropriate to separate the basket of rights, including detention and retention, conferred on the airport by virtue of the security into its component parts for the purpose of seeking to draw a fine distinction between one step and another when each was a constituent part in the enforcement process. The mere assertion of the right to detain involved at least an element of enforcement.

There were many examples from parallel fields such as money lenders and their rights of retention and enforcement: see *Mayfair Trading Co. Pty. Ltd. v. Dreyer* [1959] A.L.R. 104 ; *Mitchener v. Equitable Investment Co. Ltd.* [1938] 2 K.B. 559 ; *Cohen v. J. Lester Ltd.* [1939] 1 K.B. 504 and *Kasumu v. Baba-Egbe* [1956] A.C. 539 .

If the right under section 88 did not amount to security from the date of the debtor's default the only logical date when it could become a security was the date of actual detention of the aircraft. If that date was after the date of an order for administration the curious position was reached that although the airport was unsecured at the date of an order for administration it could take steps to become secured without the leave of the court during the course of the administration to the prejudice of the general body of unsecured creditors. It was highly unlikely that Parliament intended that the ring fence of administration could be deliberately evaded in that way.

In such circumstances section 11(3)(d) came into play. Two issues arose in relation to that provision: whether seeking to assert the statutory right constituted either "other proceedings" or "distress." The subsection should not be given the very restricted meaning argued for by the appellant and apparently approved by the court in *Air Ecosse Ltd. v. Civil Aviation Authority* (1987) 3 B.C.C. 492 .

There was no reason to limit the concept of "other proceedings" to proceedings in a court of law. There were powerful indications in section 11 that the concept extended to extra-judicial proceedings. The word "proceedings" was preceded by the word "other" and was followed by a myriad of other rights which were prefaced in each case by the word "and." When the draftsman meant to refer to legal process he did so expressly.

In construing the word "other" the court should have regard to the *eiusdem generis* rule: *Quazi v. Quazi* [1980] A.C. 744 . The genus, if any, to which the word "other" referred was actions or conduct of any sort by a person or body of persons affecting the company or its property which might interfere with the achievement of the purpose of the administration. Steps taken to enforce security over the company's property might be, and often were, non judicial. So too were steps taken to repossess goods in the company's possession under any hire purchase agreement. The reference in section 11(3)(d) to "other proceedings" included detention under section 88 of the Civil Aviation Act 1982.

To complete a distress seizure of the goods was necessary. Once an aircraft was on the tarmac of an airport the very act of detention involved seizure because the operator could not do anything physically *751 to remove the aircraft. The absence of the word "seizure" from section 88 did not necessarily mean that detention was a lesser power.

It could be argued that the exercise by an airport of the right to detain under section 88 was a distress because it was a summary remedy by which an airport was entitled without legal process to take into its possession the personal chattel of another person to be held as a pledge to compel payment of a debt. Examples from other fields could be seen in *The Queen of the South* [1968] P. 449 and *In re Herbert Berry Associates Ltd.* [1977] 1 W.L.R. 1437 .

Assuming the right under section 88 of the Act of 1982 was covered by section 11(3) of the Act of 1986 the airports should not have been given leave to detain. Leave would have run counter to the purpose of the administration order. The airports took a commercial decision in their own interests on the appointment of the administrators not to seek to enforce their security and were content not to seek to do so until the end of the holiday season. They should not now be allowed to blow hot and cold.

No complaint had been made that the administrators had been tardy in seeking to perform their statutory duties or were unduly protracting the period of the administration: see *Royal Trust Bank v. Buchler* [1989] B.C.L.C. 130 . No arguments had been advanced as to why the two aircraft should not remain available for the purposes of the remainder of the administration. In all the circumstances it was right to regard the airports recent behaviour as amounting to an attempt at commercial blackmail which the court should not assist by granting leave.

Robert Webb Q.C., Michael Crane and Gregory Hill for the third respondents. Leave was needed from the courts before the airports could seek to exercise any rights under section 88 of the Civil Aviation Act 1982. The scheme of administration tended to that result. A unique characteristic of administration was that a principle statutory objective was the survival of the whole or a part of a failing business as a going concern, hence the need for a ring fence round the creditors. It followed that the right to detain had to be perfected by an overt act constituting a manifestation of the intention to detain. Phillips J. had been correct in *Havelet Leasing Ltd. v. Cardiff-Wales Airport Ltd* (unreported), 29 June 1988. Retaining possession was not enforcing a lien.

The effects of holding an aircraft at an airport were draconian. In the instant case it threatened the sale of Paramount as a going concern and put the jobs of all its employees at risk as well as causing disruption to holiday makers. It was unlikely that the draftsman in settling section 11 of the Act of 1986 chose to ignore the effect of section 88, that followed if only because the exercise of the section 88 power had the effect of bringing the company in administration to a standstill: see *The Standard Austria S.H. 1964* [1965] 2 Lloyd's Rep. 189 . The naturally constrictive meaning of section 88 should not be extended: see *Air Canada v. Secretary of State for Trade* [1981] 3 All E.R. 336 .

The power under section 88 was something so near to distress as to be almost the same thing and thus its exercise came within the ambit of section 11(3)(d) of the Act of 1986 as either a "distress" or "other proceedings." The remedy of distraint was not archaic: see section *752 176(2) of the Act of 1982 which bit on the proceeds of sale of a company's interest in an aircraft at the end of the section 88 process.

Lightman Q.C. in reply. There was a significant distinction between the power to seize and the power to detain. The airports had had no wish to seize the aircraft and no intention to exercise distress. "Proceedings" in section 11(3)(d) meant legal proceedings.

The statutory right under section 88 was not a security despite its similarity. It was merely a right to require property to remain at the airport. The airport was not a pledgee or chargee. Nor was the right a lien: see *Channel Airways Ltd. v. Manchester Corporation* [1974] 1 Lloyd's Rep. 456 and *The Ally* [1952] 2 Lloyd's Rep. 427 .

The Civil Aviation Act created a special code for dealing with airports. It could not have been intended that the Insolvency Act should interfere with that code and stop it having full operation and effect.

It was accepted that security arose when the power was exercised. However, that perfection of the security was not a step to its enforcement. Enforcement had a special meaning in the context of money lenders because special principles were involved and cases involving money lenders such as *Kasumu v. Baba-Egbe* [1956] A.C. 539 offered no help in the instant case.

The second respondents were not represented and did not appear.

Cur. adv. vult.

21 December. The following judgments were handed down

SIR NICOLAS BROWNE-WILKINSON V.-C.

This case raises a difficult question as to the interaction between the powers of an administrator of a company appointed by the court under [Part II of the Insolvency Act 1986](#) and the right of an airport to detain an aircraft for unpaid charges under [section 88 of the Civil Aviation Act 1982](#) ("the statutory right of detention"). The case has a wider importance since it is the first in which this court has had to consider the new administration procedure for dealing with insolvent companies introduced by the [Insolvency Act 1985](#) and the rights of such administrator to possession of the assets of the company: but see [Air Ecosse Ltd. v. Civil Aviation Authority \(1987\) 3 B.C.C. 492](#) where the Court of Session had to consider a different point under the Act of 1986.

The facts

I gratefully adopt the summary of the facts given in the skeleton argument lodged by the administrators.

Paramount Airways Ltd. (Paramount) is a charter airline operating out of several United Kingdom airports including Bristol Airport (Bristol) and Birmingham International Airport (Birmingham).

On 7 August 1989 Paramount was insolvent. Its statement of affairs shows a deficiency as regards creditors on that date of over £11m. Amongst its unsecured creditors on that date were Bristol and Birmingham. Bristol was owed £1,215,889-odd. Of this sum just under [*753](#) £700,000 was owed in respect of landing fees, etc. and just over £500,000 was in respect of fuel. In respect of one of the detained aircraft (G-PATB) £267,000-odd was owed in respect of landing charges, etc. and £201,000-odd was owed in respect of fuel. On the same date, 7 August 1989, Paramount was indebted to Birmingham for £466,000-odd for airport charges. Of these about £160,000 was owed in respect of the aircraft detained by them (G-PATA). On 7 August 1989 none of the aircraft operated by Paramount were at Bristol or Birmingham. It follows that, if Paramount had gone into liquidation on 7 August 1989 neither Bristol nor Birmingham would have had any aircraft capable of being detained under the Act of 1982; they would have been unsecured creditors in the liquidation.

On 7 August 1989 an administration order was made by Warner J. under [section 8](#) of the Act of 1986. The administration order was made for the following purposes: (a) the survival of Paramount and the whole or any part of its undertaking as a going concern; (b) the approval of a voluntary arrangement under Part I of the Act of 1986; and (c) a more advantageous realisation of Paramount's assets than would be effected on a winding up. Two chartered accountants were appointed administrators under the order.

At the date of the administration order Paramount was the licensed operator of certain aircraft including an MD-83(G-PATB), a Boeing 737 and an MD-83(G-PATA). Paramount was operating these aircraft under a sub-lease from Irish Aerospace Leasing Ltd. under leases expiring in about 1994. Irish Aerospace Leasing Ltd. was itself the lessee of those aircraft. Air 2000 Ltd., the third respondent to this appeal, was the petitioning creditor.

On 7 August 1989 the administrators entered into an arrangement with Bristol whereby it was agreed that Paramount's aircraft would be permitted to land and depart from Bristol Airport in consideration of Paramount paying Bristol's standard charges. It is not alleged that this constituted a waiver by Bristol of its rights to detain the aircraft for charges incurred prior to the administration order. There was no similar arrangement made with Birmingham. After 7 August 1989 the administrators caused Paramount to continue its trading. Since that date Paramount has flown over 30,000 passengers to foreign destinations from 11 airports in the United Kingdom, including Bristol and Birmingham. In respect of all these flights £6,700,000 has been paid by Paramount in respect of airport charges and fuel to all the airports used, including substantial sums to both Bristol and Birmingham. All airport charges which have been incurred during the course of the administration, including all airport charges payable to Bristol and Birmingham, have been paid by the administrators. The debts now due to Bristol and Birmingham are the same debts that were due on 7 August 1989 in respect of charges incurred prior to the making of the administration order on 7 August 1989.

By the middle of October 1989 the administrators had formed the view that there was a real prospect of a sale of the business of Paramount being achieved on terms which would be beneficial to the general body of Paramount's creditors. Accordingly, notices were sent [*754](#) out to creditors calling the meeting required under [section 23 of the Insolvency Act 1986](#) for Friday

3 November 1989. On 30 October 1989 a meeting took place between representatives of four airports (including Bristol and Birmingham) at which an understanding was reached that none of them would exercise any power of detention until after the creditors' meeting on 3 November 1989.

On 2 November 1989 both Bristol and Birmingham became anxious that, as the holiday season was coming to an end, the aircraft might be about to leave the United Kingdom or otherwise be routed so as not to return to their respective airports. On that date there were two Paramount aircraft at Bristol, G-PATB and the Boeing 737. Bristol applied ex parte to Harman J. for leave to detain the two aircraft and such leave was granted over the hearing of an inter partes application on Monday 6 November 1989. Bristol permitted the Boeing 737 to leave Bristol and fly to Australia. G-PATB was detained and remained detained until 14 November 1989.

On the same day, 2 November 1989, Paramount had aircraft G-PATA at Birmingham. This aircraft had charter commitments with a German firm for weekend return flights. In the course of the afternoon of 2 November Birmingham learned of the order made by Harman J. In conversations with a representative of the administrators, Birmingham was informed that they could not detain G-PATA without leave of the court. Without obtaining the leave of the court, on the same afternoon Birmingham parked a lorry laden with concrete in front of G-PATA. At approximately 6 p.m. that evening the captain of G-PATA arrived at Birmingham and was served with a "lien notice." At about 8 p.m. on 2 November Birmingham obtained ex parte from Hodgson J. an order giving Birmingham leave to detain G-PATA over the hearing of an inter partes application on Monday 6 November, before the Companies Court in London. G-PATA was detained by Birmingham down to 14 November 1989.

The meeting of Paramount's creditors summoned by the administrators took place on 3 November 1989. An offer for Paramount's business and assets was put before the meeting of creditors by the administrators. The meeting was attended by representatives from both Bristol and Birmingham. The offer was approved in principle by the creditors without dissent. The proposed sale was incapable of performance if the aircraft remained detained.

The applications for leave to detain by Bristol and Birmingham came before Harman J. in the Companies Court on Monday 6 November 1989, the respondents being the administrators, Irish Aerospace Leasing Ltd. and Air 2000 Ltd. The matter was argued for three days but, given the urgency of the matter, Harman J. had to give an immediate judgment which he delivered on Friday 10 November 1989. The judge held that the airports required the leave of the court under [section 11](#) of the Act of 1986 before exercising their statutory right to detain the aircraft and, in the exercise of his discretion, refused to grant such leave. Birmingham and Bristol appeal against that decision.

Bristol and Birmingham immediately applied to this court to safeguard their position pending appeal. This court directed that the appeal should [*755](#) be heard on 21 November 1989 and that in the interim Bristol and Birmingham should have leave to detain the two aircraft until after the hearing of the appeal or until such earlier time as the sum of £350,000 should be paid into court or otherwise secured, the parties having agreed that in the event that £350,000 was so paid or secured all rights and claims of the airports in respect of the two aircraft should be transferred to that sum. The sum of £350,000 was so provided and the detention of the aircraft ceased on 14 November 1989.

Leave to appeal has been given by Harman J.

The statutory right of detention

[Section 88\(1\) of the Civil Aviation Act 1982](#) provides:

"Where default is made in the payment of airport charges incurred in respect of any aircraft at an aerodrome to which this section applies, the aerodrome authority may, subject to the provisions of this section - (a) detain, pending payment, either (i) the aircraft in respect of which the charges were incurred (whether or not they were incurred by the person who is the operator of the aircraft at the time when the detention begins); or (ii) any other aircraft of which the person in default is the operator at the time when the detention begins; and (b) if the charges are not paid within 56 days of the date when the detention begins, sell the aircraft in order to satisfy the charges."

[Subsection \(3\)](#) provides that the aircraft shall not be sold without the leave of the court which must first be satisfied that a sum is due for airport charges, that default has been made in payment of such charges and that the aircraft is liable for sale under the section. [Subsection \(4\)](#) requires notice of any application for leave to sell to be given to persons whose interests may be

affected by such sale so as to afford them an opportunity of becoming parties to such application. [Subsection \(6\)](#) provides that the proceeds of sale are to be applied in paying any customs or excise duty chargeable, the expenses of detaining, keeping and selling the aircraft, the airport charges which are unpaid and charges due by virtue of [section 73](#) of the Act (which relate to charges for Eurocontrol). The surplus proceeds of sale are to be paid to or among the persons whose interests in the aircraft have been divested by reason of the sale. [Subsections \(7\) and \(8\)](#) provide that the power of detention and sale is exercisable in relation to the equipment on the aircraft and any stores and aircraft documents carried on the aircraft. Under [subsection \(9\)](#) the power to detain is expressly made exercisable not only on the occasion on which the charges have been incurred but also on any subsequent occasion when the aircraft is on the aerodrome on which the charges were incurred or on any other aerodrome owned or managed by the same authority.

There are two points which should be noted at this stage. First, it is common ground that the sale of an aircraft under this section operates so as to divest all interests in the aircraft so as to vest full legal and equitable title to the aircraft in the purchaser. Even where the charges have been incurred by a person who is not the full legal and equitable [*756](#) owner of the aircraft (such as Paramount in this case) the effect of a sale will be to divest the ultimate owners of the aircraft of their title. Their compensation, if any, lies in the direction under [subsection \(6\)](#) to apply the surplus proceeds of sale "among the person or persons whose interests in the aircraft have been divested by reason of the sale." It follows that the powers under the section provide a strong inducement to those ultimately interested in the aircraft to discharge the debts for airport charges, even though they have not incurred them.

Second, [subsection \(1\)\(a\)\(ii\)](#) requires one to determine "the time when the detention begins." In *Havelet Leasing Ltd. v. Cardiff-Wales Airport Ltd.* (unreported), 29 June 1988, Phillips J. held that, in order to exercise the statutory power of detention, the airport had to do some overt act evidencing the act of detention. He said:

"I hold that detention by an airport authority must be begun by some overt act. Such act need take no particular form. A simple declaration that the aircraft was detained, had it been made to [the operator], would have sufficed; so would an administrative act that would de facto have prevented the aircraft from being flown from the airport."

In that case he held that the fixing to the aircraft of a "lien notice" was the act of detention. That decision has not been challenged by either side in the present case and in my judgment is correct.

Administration procedure

Administration orders were introduced by the [Insolvency Act 1985](#) following a report by a committee on insolvency law and practice under the chairmanship of Sir Kenneth Cork. That report identified a shortcoming in the law relating to insolvent companies. In a number of cases, companies were forced into liquidation even though they were carrying on potentially viable businesses. Such businesses were destroyed for want of a procedure whereby they could be conducted with a view either to restoring the financial health of the company or of enabling the businesses to be sold as a going concern. If the business of the company could be sold as a going concern, it would normally command a substantially higher price than on break-up. The Cork Report contrasted that position with the case where a creditor holding a floating charge had appointed a receiver and manager who was able by continuing to run the company's business to achieve the desired result to the benefit of not only the secured creditors but also the unsecured creditors and shareholders.

The Cork Report also pointed to a separate mischief, viz. the inability in a liquidation to sell the whole of the company's business as a going concern without the co-operation and agreement of those holding fixed charges over its assets.

It is clear that the administration procedure introduced by the [Insolvency Act 1985](#) and now contained in Part II of the Act of 1986 was directed to remedying these mischiefs as the provisions of the Act of 1986 themselves make clear.

[*757](#)

[Section 8](#) of the Act of 1986 gives the court power to appoint an administrator if the court is satisfied that the company is unable to pay its debts as they fall due and considers that the making of an order would be likely to achieve one or more of the following purposes under [subsection \(3\)](#) :

"(a) the survival of the company and the whole or any part of its undertaking, as a going concern; (b) the approval of a voluntary arrangement under Part I; (c) the sanctioning under section 425 of the Companies Act of a compromise

or arrangement between the company and such persons as are mentioned in that section; and (d) a more advantageous realisation of the company's assets than would be effected on a winding up; . . ."

So long as such order is in force "the affairs, business and property" of a company are to be managed by the administrator appointed by the court. For that purpose the administrator is given very wide powers to carry on the business of the company, as the agent of the company, including power to take possession of the property of the company: [section 14 and Schedule 1, paragraph 1](#) .

Part II of the Act contains two sections designed to protect the property of the company against adverse claims. [Section 10](#) covers the period between the presentation of the petition and the making of the administration order. [Section 11](#) covers the period after the making of the order and is the section directly in point in this case. So far as relevant, it provides:

"(3) During the period for which an administration order is in force - (a) no resolution may be passed or order made for the winding up of the company; (b) no administrative receiver of the company may be appointed; (c) no other steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as the court may impose; and (d) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as aforesaid."

"Security" is defined by [section 248\(b\)](#) as meaning "any mortgage, charge, lien or other security."

The administrators in this case contend that the exercise of the statutory right of detention under [section 88](#) of the Act of 1982 falls within either [section 11\(3\)\(c\)](#) (as being a step taken to enforce any security) or within [section 11\(3\)\(d\)](#) (as being the levying of a distress or "other proceedings").

[Section 15](#) contains additional provisions relating to property subject to a charge. It distinguishes between floating charges and fixed charges. "Floating charge" is defined as "a charge which, as created, was a *758 floating charge:" [section 251](#). Therefore, for the purpose of determining whether or not a charge is a floating charge, any crystallisation of a floating charge on the making of an administration order falls to be ignored. Under [section 15\(1\) and \(4\)](#) the administrator is given power to exercise all his powers (i.e. including presumably the right to take possession) over property which is subject to a floating charge; in the event of a sale, the chargee's rights are shifted to the proceeds of sale. The position is different as respects property subject to a fixed charge. The administrator is given no general power to exercise his rights over such property: but the court can give leave to the administrator to dispose of such property, the proceeds of sale being applied in discharge of the secured debt: [section 15\(2\) and \(5\)](#) .

The issues

A. Under [section 11\(3\)\(c\)](#). (1) Were these aircraft, notwithstanding the fact that they were only leased by Paramount, "property" of the company within the meaning of the subsection? (2) Is the statutory right of detention under [section 88](#) a lien or other security within the definition in [section 248](#) of the Act of 1986? (3) Is the exercise of the statutory right of detention "a step taken to enforce any security" which requires the leave of the court under [section 11](#)?

B. Under [section 11\(3\)\(d\)](#). (1) Does the detention of the aircraft constitute the levy of a distress? (2) Does the detention of the aircraft constitute "other proceedings" within the meaning of the subsection or does the word "proceedings" mean only legal or quasi-legal actions?

C. If the detention of the aircraft required the leave of the court under [section 11\(3\)](#) , did the judge properly exercise his discretion by refusing such leave?

The approach to the construction of the Act of 1986

Before dealing with the issues summarised above, it may be helpful to state what, in my opinion, is the correct approach to the construction of the provisions dealing with administrators contained in Part II of the Act. The judge was very much influenced

in his construction by the manifest statutory purpose of Part II of the Act. I agree with this approach. The provisions of Part II themselves, coupled with the mischief identified in the Cork Report, show that the statutory purpose is to install an administrator, as an officer of the court, to carry on the business of the company as a going concern with a view to achieving one or other of the statutory objectives mentioned in [section 8\(3\)](#). It is of the essence of administration under Part II of the Act that the business will continue to be carried on by the administrator. Such continuation of the business by the administrator requires that there should be available to him the right to use the property of the company, free from interference by creditors and others during the, usually short, period during which such administration continues. Hence the restrictions on the rights of creditors and others introduced by [sections 10 and 11](#) of the Act. In my judgment in construing Part II of the Act it is legitimate and necessary to bear in mind the statutory objective with a view to [*759](#) ensuring, if the words permit, that the administrator has the powers necessary to carry out the statutory objectives, including the power to use the company's property.

On the other hand, however desirable it may be to construe the Act in a way calculated to carry out the parliamentary purpose, it is not legitimate to distort the meaning of the words Parliament has chosen to use in order to achieve that result. Only if the words used by Parliament are fairly capable of bearing more than one meaning is it legitimate to adopt the meaning which gives effect to, rather than frustrates, the statutory purpose.

A. The issues under section 11(3)(c)

(1) Were the aircraft "property" of the company?

Mr. Lightman, for the airports, submits that because the aircraft were only held by Paramount under chattel-leases they are not "property." The aircraft, he submits, were the property of the ultimate lessor: Paramount has only contractual rights.

"Property" is defined by [section 436](#) as follows:

"'Property' includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property."

It is hard to think of a wider definition of property.

In my judgment, the interest of Paramount under a lease of the aircraft is plainly property within that definition. It is true that, to date, concepts of concurrent interests in personal property have not been developed in the same way as they have over the centuries in relation to real property. But modern commercial methods have introduced chattel-leasing. The Act of 1986 refers expressly to such leases: see [section 10\(4\)](#). Although a chattel lease is a contract, it does not follow that no property interest is created in the chattel. The basic equitable principle is that if, under a contract, A has certain rights over property as against the legal owner, which rights are specifically enforceable in equity, A has an equitable interest in such property. I have no doubt that a court would order specific performance of a contract to lease an aircraft, since each aircraft has unique features peculiar to itself. Accordingly in my judgment the "lessee" has at least an equitable right of some kind in that aircraft which falls within the statutory definition as being some "description of interest . . . arising out of, or incidental to" that aircraft.

(2) Is the statutory right of detention a "security over the company's property?"

Section 248 of the Act of 1986 defines "security" as including a "lien or other security." There was some discussion in the course of argument whether the statutory right of detention is strictly to be described as a "lien." It has many of the features of a lien. It is a right of retention of chattels enjoyed by a creditor against the payment of his charges for services rendered in relation to those chattels, similar to the rights enjoyed by, for example, repairers of goods. The fact that the right is conferred by statute is not inconsistent with it being a lien: see [*760](#) Halsbury's Laws of England, 4th ed., vol. 28 (1979), p. 223, para. 506. However, it is not a possessory lien of the classic type, since (as will appear hereafter) in my judgment the statutory right of detention conferred by [section 88](#) does not give the airport legal possession of the aircraft whilst it is being detained. But there are many species of lien which do not depend on possession, for example certain equitable liens: p. 222, para. 503. In *Channel Airways Ltd. v. Manchester Corporation* [1974] 1 L.R. 456, Forbes J. held that a right very similar to the statutory right of detention but conferred by a Private Act was not strictly a lien.

Whether or not the statutory right of detention is strictly to be regarded as a lien, in my judgment apart from any special context it would certainly fall within the description "other security." Mr. Crystal, for the administrators, submitted the following description of a security: "Security is created where a person ('the creditor') to whom an obligation is owed by another ('the debtor') by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains rights exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtor's obligation to the creditor."

Whilst not holding that that is a comprehensive definition of "security," in my judgment it is certainly no wider than the ordinary meaning of the word. The statutory right of detention confers on the airport (as creditor) the right to detain and, with the leave of the court, sell the aircraft for the purpose of discharging debts incurred to that airport by the operator or by previous operators. In my judgment it is plainly a security.

I did not understand Mr. Lightman to take issue with those propositions in general. His submission was that the statutory right of detention has special features which make it sui generis and therefore the word "security" in sections 11 and 248 of the Act of 1986 should be construed so as to exclude this very special statutory right. He pointed out that the statutory right of detention extends to debts owed otherwise than by the person operating the aircraft at the time of detention; that a sale under section 88 can only take place with the leave of the court and operates to divest, not only the debtor's interests in the aircraft, but all other interests such as those of mortgagees and the ultimate owner. Moreover section 88(6) establishes its own order of priorities in the application of proceeds of sale of the aircraft.

Whilst accepting the force of these submissions, they do not persuade me that the words "other security" in the Act of 1986 ought to be given anything other than their natural meaning. The statutory right of detention in section 88, although unusual, is not unique. Parliament has conferred on port authorities similar rights in relation to the enforcement of the payment of port dues: see section 75 of the Port of London (Consolidation) Act 1920, quoted in *The Queen of the South [1968] P. 449*, 457. We were not referred to any case in which a specific statutory right has been held to fall completely outside the statutory framework laid down for dealing with insolvent companies. Moreover, to construe the Act of 1986 so as to exclude the statutory right of **761* detention from its ambit would run counter to the purposes of the administration procedure since it would leave airports and those enjoying similar rights free to take action to enforce payment of their debts, thereby preventing or hindering continuation of the business by the administrator. In my judgment it would not be right to give the general words "other security" a narrower meaning than they would normally bear since that would tend to frustrate the purposes of Part II of the Act of 1986.

I therefore hold that the statutory right of detention is a "lien or other security" within the meaning of sections 11 and 248 of the Act of 1986.

(3) Is the exercise of the statutory right of detention a "step taken to enforce" a security?

Mr. Lightman submits that the overt act necessary to constitute the exercise of the statutory right of detention (i.e., the blocking of the aircraft or the service of a notice of lien) is not a step to enforce the security but a step to create or perfect the security. He submits that, in the present case, security was either created for the first time by the overt act of detention or, at least, such acts were only done to perfect what until then had been an inchoate security (i.e., a right to create a security by the overt act). The mere detention of an aircraft, says Mr. Lightman, is not the taking of a step to enforce the security.

This is an important point since, to my mind, it raises the question of an administrator's right to possession of chattels which are subject to a possessory lien or similar right. Although there are special features of the statutory right of detention conferred by section 88, the starting point must be to discover what are the rights of the administrator to obtain possession of chattels from those claiming a right of retention the exercise of which involves no positive action by the creditor save a refusal to comply with a request to hand over the chattel. Is such a refusal a "step . . . taken to enforce" the lien or other similar security? Although administrations involving aircraft are likely to be comparatively rare, nearly all administrations will raise the question whether, for example, company vehicles subject to a repairer's lien or goods consigned on the terms that the carrier has a lien on such goods can be withheld from the administrator unless he pays the debt in full.

If retention under such possessory lien does not require the leave of the court under section 11, this will be an exception to the normal rule. The administrator will be forced either to seek to run the business without the chattels so retained or to pay in full and at once the amount owed to the lien holder. As in the present case, it may not be possible to run the business without the chattels. If the creditor claiming the lien is to be paid in full, he will be placed in a uniquely favourable position compared with all other creditors. During the administration an unsecured creditor cannot, without the leave of the court, enforce his debt

by action so as to obtain immediate payment: section 11(3)(b). Secured creditors cannot appoint a receiver or enforce their security in any other way: section 11(3)(b) and (c). The policy of the Act is plainly to impose a moratorium on the payment of debts save to the extent that *762 the administrator chooses to pay (in order, for example, to obtain further supplies from a creditor) or the court so directs.

Against that background, I turn to see what guidance is afforded by the words of the Act themselves. I suspect that, save in one regard, the draftsman may have overlooked the need for an administrator (as opposed to a liquidator) to obtain possession of chattels for the purpose of continuing to run the company's business. The only specific provision dealing with liens is section 246 which, so far as relevant, provides:

"(2) Subject as follows, a lien or other right to retain possession of any of the books, papers or other records of the company is unenforceable to the extent that its enforcement would deny possession of any books, papers or other records to the office holder. (3) This does not apply to a lien on documents which give a title to property and are held as such."

"The office holder" is defined by subsection (1) as meaning an administrator, liquidator or provisional liquidator as the case may be.

Mr. Lightman relied on this section as indicating that, save in the case of documents, a possessory lien will be enforceable so as to deny the administrator possession of the chattel subject to the lien and that accordingly no leave would be required under section 11(3). In my judgment that is not necessarily the underlying assumption behind the section. Let me assume for the moment that the assertion of a right to retain a chattel under a lien is within section 11(3). The only consequence is that leave to enforce such right is required: apart from that restriction, the lien holder's right to retain the chattel remains and may well be permitted by order of the court. However, in the case of documents falling within section 246(2) the right to retain as against the administrator is unenforceable: the holder of the lien over documents could not apply to the court under section 11(3) for leave to retain since under section 246(2) he has no right to retain which the court could give him leave to exercise. For that reason, in my judgment there is no necessary conflict between section 246 and a construction of section 11(3)(c) which requires the leave of the court for the exercise of a right of retention under a possessory lien.

There is another feature of section 246(2) which in my judgment strongly supports the view that the exercise of a right to retain under a lien constitutes the enforcement of the security. Section 246(2) provides that "a lien or other right to retain possession . . . is *unenforceable* to the extent that its *enforcement*" would deny possession (my emphasis). The words I have emphasised show that in the Act of 1986 the mere insistence by a lien holder on his right to retain constitutes "enforcement" of the lien. On ordinary principles, the same word used in different sections of the Act should normally be given the same meaning. Hence the word "enforce," when used in section 11(3) in relation to a lien, *prima facie* includes the assertion by the lien holder of his right to retain.

Therefore, both the limited guidance provided by the words of the Act of 1986 and the desirability of giving effect to the statutory purpose of the administration procedure both point to leave being required *763 under section 11(3)(c). There are however practical considerations which are said to point the other way. First, it is said that by being forced to give up possession of the chattel, the person entitled to a possessory lien over it will lose his security: the loss of possession under a possessory lien involves the loss of the security: it cannot be right that the appointment of an administrator has the effect of turning a secured into an unsecured creditor. But this submission overlooks the fact that the only requirement of section 11(3) is to require the leave of the court to the exercise of the right of retention. In the ordinary case where a lien holder seeks to assert his lien from the outset of the administration, on an application for leave under section 11(3) the court, if satisfied that the administrator needs possession of the chattel, would in the exercise of its discretion normally impose terms whereby the lien over the goods was retained, notwithstanding the loss of possession, or provide some other suitable security for the lien holder.

Again, it is said that it would be ridiculous to require an application to the court in the case of every possessory lien, however small. In my judgment that would not be the consequence of upholding the administrators' claim in this case. An administrator in exercise of his powers (particularly those contained in paragraphs 18 and 23 of Schedule 1 to the Act) could agree with the lien holder that possession of the chattel was to be given up on the terms that the lien holder continued to enjoy a non-possessory lien over the chattel.

I therefore reach the conclusion that, in the case of an ordinary possessory lien, the assertion by the lien holder of a right to retain constitutes the taking of a step to enforce his security within section 11(3) of the Act of 1986 and therefore, in default of agreement with the administrator, requires the leave of the court.

Do the special features of the statutory right of detention under section 88 lead to a different conclusion in the present case? Although there are differences between the normal possessory lien and the statutory right of detention, in general the two rights are very similar, viz. a passive right to retain a chattel against payment of a debt. Mr. Lightman urges that there are two matters (one technical, the other practical) which make this case different.

First, he submits that the overt act of detaining the aircraft is the act which creates the security, not one which enforces it. He submits that until there has been that overt act of detention, the airport has no security at all: it merely enjoys the statutory right to create the security by an act of detention. Therefore, he says, such detention cannot be a step taken to enforce the security. There was much discussion in the course of argument as to whether any security existed before the overt act of detention. It was suggested that the security existed at all times when relevant charges existed wherever the aircraft might be; alternatively, that the security came into existence when an aircraft touched down at the airport there being subsisting relevant charges which could give rise to a detention at that airport. I find such analysis artificial and unconvincing. In my judgment Mr. Lightman is right in saying that the airports enjoyed no actual security until they detained the aircraft by an overt act of detention. But I am not persuaded that, *764 just because the overt act of detention created or perfected the security, it was not also the taking of a step to enforce that security. There is no legal reason why the same act should not have a dual effect as being both the perfection of the security and a step taken to enforce it. Plainly, as a matter of commercial common sense, the detention of the aircraft in this case did enforce the right of detention in just the same way as does a refusal by a lien holder to hand over the chattel. The artificiality of the argument can be demonstrated by considering what would be the position if, immediately after the notice of lien was served, the administrators had demanded the giving up of the aircraft. The refusal to meet such demand would have been indistinguishable from the refusal of a lien holder to hand over the chattel subject to a possessory lien. It seems to me unnecessarily artificial to say that in this case there had to be a separate demand for the detained aircraft in order to constitute an enforcement of the security by the airport.

Mr. Lightman's second point concentrated on the mobility of aircraft. Once an aircraft has left the airport, the rights under section 88 come to an end unless and until it returns to that airport. The aircraft may have left the jurisdiction, never to return and be beyond the reach of any order of the court. Even if the aircraft returns to the United Kingdom, it may not return to the same airport. If, therefore, before exercising the statutory right of detention, the airport has to obtain the leave of the court, the aircraft may well have gone beyond recall even if the application is heard within hours and is successful. If, as Harman J. held in the case of Birmingham, the detention of the aircraft before the leave of the court was obtained is a contempt of court as an interference with the possession of an officer of the court, the airport is placed in an impossible position.

These are powerful arguments. Plainly, an airport should not lose its rights under section 88 simply because there is no time to obtain prior leave of the court. But in my judgment on a proper view of the matter the practical repercussions are not as serious as they are submitted to be. I think it unlikely that, after the judgment of this court has been digested, an administrator will seek to spirit away an aircraft without giving an airport time to apply ex parte for an interim order giving leave to detain, which will no doubt be granted on the usual cross-undertaking in damages. If, contrary to that prognosis, an administrator were to make such an attempt, in my judgment an airport would run no risk of being in contempt of court if at the same time as it detained the aircraft it made every effort to obtain the leave of the court which can normally be obtained in a matter of hours. I am unable to agree with the judge that Birmingham may have been in contempt of court in this case if, as I understand the position to have been, they were apprehensive that the aircraft was going to leave that airport almost immediately.

For these reasons, in my judgment the leave of the court to exercise the statutory power of detention contained in section 88 was required under section 11(3)(c). I should make it clear that this decision as to the right of detention under section 88 of the Act of 1982 does not extend to other rights of detention under that Act, for example section 64(7) (operating without a licence) and section 78(5) (noise and vibration).

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It is therefore strictly unnecessary to consider the position under section 11(3)(d), but since the judge primarily based his decision on paragraph (d) it is desirable for me to do so.

B. The issues under section 11(3)(d)

(1) Distress.

The administrators claim that, by detaining the aircraft, the airports were levying a distress within the section and that therefore the leave of the court is required. This was the primary ground of the judge's decision. I am unable to agree with his view on this point. There is no doubt that the statutory right of detention has many similarities to the ancient remedy of distraint: it is a right for a creditor to exercise control over chattels, whereby the debtor is prevented from using them, as a pledge for the payment of a debt owed by the debtor to the creditor. But it lacks one essential feature of a distraint, namely that under the statutory right of detention the aircraft is not taken into the possession of the airport. Under section 88, the power is to detain, not to seize and detain. The airport can take all necessary steps to prevent the aircraft leaving and to prevent any spares and documents being removed from it: but it has no right to exclude the owner from the aircraft completely. Therefore in my judgment the statutory right to detain is not strictly a right of distraint.

Moreover, although statutes have created statutory rights of distress, counsel could find no case in which a statutory provision had been held to be a right of distraint in the absence of clear words describing the right as a right to distraint. Distress is an ancient remedy and to a degree obsolescent. In my judgment in the absence of clear words in section 88 describing the right to detain as being a right of distress, it would be wrong to treat it as such.

(2) "Other proceedings."

The administrators submit, and the judge held, that the detention of the aircraft required the leave of the court as being "other proceedings . . . against the company or its property."

I have no hesitation in rejecting that view. In my judgment the natural meaning of the words "no other proceedings . . . may be commenced or continued" is that the proceedings in question are either legal proceedings or quasi-legal proceedings such as arbitration. It is true that the word "proceedings" can, in certain contexts, refer to actions other than legal proceedings, e.g. proceedings of a meeting. In *Quazi v. Quazi [1980] A.C. 744* the House of Lords held that a divorce by Talaq in Pakistan constituted other proceedings within the statutory phrase "judicial or other proceedings." But in that phrase the word "other" must have referred to non-judicial proceedings since judicial proceedings had already been expressly referred to. No such special feature is present in [section 11\(3\)\(d\)](#) .

Further, the reference to the "commencement" and "continuation" of proceedings indicates that what Parliament had in mind was legal proceedings. The use of the word "proceedings" in the plural together with the words "commence" and "continue" are far more appropriate to **766* legal proceedings (which are normally so described) than to the doing of some act of a more general nature. Again, it is clear that the draftsman when he wished to refer to some activity other than "proceedings" was well aware of the word "steps" which he used in [section 11\(3\)\(c\)](#) .

The judge took the view that the words "other proceedings" covered

"every sort of step against the company, its contracts or its property which may be taken and the intention of Parliament by section 11 is to prevent all such, without the leave of the court or the administrators."

In my judgment, however anxious one may be not to thwart the statutory purpose of an administration, the judge's formulation must be too wide. If the word "proceedings" has this wide meaning, all the other detailed prohibitions in section 11(3) would be unnecessary. Moreover such a construction would introduce great uncertainty as to what constituted commencement or continuation of proceedings. Would the acceptance of a repudiation of a contract by the company constitute a "proceeding"? Would a counter-notice claiming a new tenancy under the Landlord and Tenant Act 1954 be a "proceeding"? In my judgment, the judge's view would produce an undesirable uncertainty which, in view of my construction of section 11(3)(c), it is unnecessary to introduce into the Act.

C. Did the judge properly exercise his discretion by refusing leave to enforce?

The judge, in the exercise of his discretion, refused to grant the airports leave to enforce their security. He took the following matters into consideration. First, he referred to the fact that there was or might be a deficiency as against unsecured creditors of £11m. or more. The judge had taken the view that the airports were not secured creditors and therefore should not be allowed to gain priority over the other unsecured creditors by detaining the aircraft. Next, he referred to the fact that the detention of the aircraft would prevent the realisation of the business as a going concern which had been approved at the meeting of creditors,

attended, without dissent, by representatives of both Birmingham and Bristol. Next, he took into account the fact that throughout the administration the airports had stood by and taken the benefit of the flying operations carried out by the administrator throughout the summer in return for which they had received very substantial sums in excess of what they would have received had the business gone into liquidation on 7 August. He treated the airports as "blowing hot and cold," taking the benefits while they might and then seeking to assert inconsistent rights thereafter. Finally, as I have said, he took the view that Birmingham by obstructing the aircraft before obtaining the leave of the court was probably in contempt of court and took this into account.

In my judgment the judge took into account the relevant factors and did not take into account any irrelevant factors save the view, which I do not share, that Birmingham may have been in contempt of court. However, it is clear that that factor would have made no difference to *767 the exercise of his discretion, since he pointed out expressly that the same matter could not be taken into account as against Bristol: yet he reached the same conclusion in relation to both airports. Therefore, in my judgment the exercise of his discretion is not reviewable in this court.

I would for myself go further and say that I completely agree with his decision. If, at the outset of an administration a secured creditor wishes to enforce his security in a way inconsistent with the achievement of the statutory purposes, he should make his position clear at the outset. To stand by and accept all the benefits of an administration and then, at the eleventh hour, seek to enforce a right which is inconsistent with the achievement of the statutory purpose is in my judgment unacceptable. The position in the present case is worse since on 7 August there were no aircraft at either Bristol or Birmingham; therefore at the commencement of the administration by the court the airports were unable to make themselves into secured creditors by exercising the statutory right of detention. Only as a result of the operations of the administrators, acting under the administration order, did the aircraft ever come to Bristol or Birmingham again. They are seeking to achieve an outcome where, as a result of the administration of the company under the order of the court, they achieve greater rights than they would have done had the company gone into liquidation on 7 August. Further, they have reaped substantial benefits by the continued operation of the aircraft, giving rise to the payment by the administrators to both Bristol and Birmingham of substantial charges as they accrued due. In my judgment, whilst the administration procedure should not be used so far as possible to prejudice those who were secured creditors at the time when the administration order was made in lieu of a winding up order, nor should it be used so as to give the unsecured creditors at that time security which they would not have enjoyed had it not been for the administration.

I have had the opportunity of reading the judgment of Woolf L.J. with which I agree. I have also read the judgment of Staughton L.J. I share his concern as to the practical results of our decision but believe that the suggestions made by Woolf L.J. meet a number of the practical difficulties.

WOOLF L.J.

I have read the judgments of Sir Nicolas Browne-Wilkinson V.-C. and Staughton L.J. Subject to what I have to say hereafter I agree that this appeal has to be dismissed for the reasons given by the Vice-Chancellor.

I am concerned about the practical implications of our judgment. While I regard it as most important that the clear policy of Part II of the Insolvency Act 1986 which the Vice-Chancellor has identified should not be frustrated, I also regard it as important that that policy should not result in Part II of the Act of 1986 interfering unduly with the statutory rights of detention given to airport authorities under section 88 of the Civil Aviation Act 1982 and the more general rights of those who are entitled to detain goods under a lien.

It appears there are four problems which have to be considered.

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(1) The prejudice which would be caused to a person entitled to the statutory right to detain under [section 88 of the Aviation Act 1982](#) or to the right to detain under a possessory lien (the detainer) if he is not entitled to detain the aircraft or other goods pending an application for leave to enforce his right under [section 11\(3\)\(c\)](#) of the Act of 1986. (The interim detention problem.)

(2) Unless the amount of charges which are unpaid is reasonably substantial the detainer will not consider it worthwhile incurring the costs of making an application for leave and so for practical purposes the right of detention could become worthless. (The costs problem.)

(3) Different people can have an interest in an aircraft or other goods. If the effect of section 11(3)(c) is to make it necessary for an application to be made to the court for leave to detain where any of those persons are the subject of an administration

order, it could be extremely difficult for the detainor to ascertain whether or not he can lawfully detain an aircraft or other goods without leave of the court. (The multiplicity of interests problem.)

(4) Different interests in an aircraft or other goods can change hands without the detainor being aware of this. Problems could arise when there is an assignment to a company subject to an administration order after an aircraft or goods had been detained if this meant that the continued detention would be automatically unlawful because of the absence of leave of the court. (The successive interests problem.)

In my judgment these problems are made less serious if it is appreciated that it is not the creation of the security without the consent of the administrator or the leave of the court which is prohibited by section 11(3)(c) but the *taking of steps* to enforce that security. You are not taking steps to enforce a security unless by relying on the security you are preventing the administrator doing something to an aircraft or other chattel in which he has an interest which he would otherwise be entitled to do. Taking first the case of the ordinary repairer who is entitled to retain goods until his charges are paid. Unless and until someone who is entitled to possession of those goods seeks to obtain possession of the goods, the lien holder does not take steps to enforce his lien. The security which is given to the lien holder entitles him to refuse to hand over the possession of the goods, but until he makes an unqualified refusal to hand over the goods he has not in my judgment taken steps to enforce the security for the purposes of section 11(3)(c) of the Act of 1986.

Similarly the right or security which section 88 of the Act of 1982 gives to the aerodrome authority is to detain pending payment either (i) the aircraft in respect of which the charges were incurred or (ii) any other aircraft of which the person in default is the operator at the time when the detention begins. The right is to prevent the operation of the aircraft by detaining it. The activities which constitute operating an aircraft are extensive and akin to any act of management as is indicated by the definition of "operator" in section 105 of the Act of 1982 as meaning "in relation to an aircraft . . . the person having the management of the aircraft for the time being or, in relation to a time, at that time." It is only when the airport authority takes steps to prevent what would *769 otherwise be the lawful operation (in that sense) of the aircraft that it enforces its security. While the same act can constitute the creation of the security and the enforcement of the security, there is nothing to prevent the aerodrome authority creating their security prior to their taking steps to enforce that security. Thus, for example, placing a notice on the aircraft would create the security even if the identity of the operator was not known. The security would be enforced when the operator arrived at the airport and tried to operate the aircraft.

Like the Vice-Chancellor, I find section 246(2) of the Act of 1986 helpful in determining what amounts to steps to enforce security for the purposes of section 11(3)(c). Section 246(2) refers to denying possession as being enforcement in the case of a lien, so in the case of the statutory right to detain contained in section 88 of the Act of 1982 it will be the denial of the ability to operate the aircraft which will constitute the enforcement.

How then does this approach assist with the problems which I have identified?

The interim detention problem

A person who comes into possession of goods lawfully is not guilty of conversion or other unlawful interference with those goods if he does not hand those goods over immediately he receives a demand from a person who is in fact entitled to possession of the goods. He is entitled first to take a reasonable time over verifying the right to the possession of the person who requires the goods to be handed over: see *Clerk and Lindsell on Torts*, 16th ed. (1989), p. 1236, paras. 22-28/29. By analogy I would not regard a person who is otherwise entitled to a lien as enforcing that lien if he does not make an unqualified refusal to hand over the goods to an administrator but instead indicates to the administrator that unless the administrator consents to his exercising his right to detain, he will apply promptly to the court for leave and does so. In my view such conduct would not amount to taking steps to enforce the lien within the meaning of section 11(3)(c) of the Act of 1986.

The position would be exactly the same in relation to the detention of an aircraft under section 88 of the Act of 1982. I would not treat the aerodrome authority as taking steps to enforce the statutory right to detain if an application is promptly made to the court and the aerodrome authority makes it clear that it is only preventing the removal of the aircraft pending determination of the question of whether it is entitled to exercise its statutory right to detain. The aerodrome authority may have brought the statutory security into existence but it is not exercising its statutory right to detain the aircraft pending payment. It is preventing the removal of the aircraft in order to ascertain whether it is entitled lawfully to detain the same pending payment. This action would not amount to conversion or wrongful interference with the aircraft. Nor would it amount to contempt. If this is the

position, then it is unlikely that Parliament intended section 11(3) to prevent and make unlawful the retention of the aircraft pending the decision of the court.

*770

Even if my interpretation of section 11(3) is not correct, the subsection expressly provides that the administrator can give his consent to the enforcement of the security and I would expect the administrator to consent to the detainor exercising his rights until an application could be made to the court bearing in mind that in a case where the administrator urgently requires the goods the court would be able rapidly to make an interim order.

The costs problem

On the interpretation of section 11(3)(c) of the Act of 1986 which I have adopted there would be no need for the detainor to make an application to the court unless this is required by the administrator. If the amount at stake is small, then I would expect the matter to be dealt with between the parties without the need of the intervention of the court. If either party acted unreasonably, then the court could be expected to use its powers in relation to costs so as to protect the party who was unreasonably involved in court proceedings.

Multiplicity of interests problem

The lien holder only needs to concern himself with an administrator of a company who claims to be entitled to possession of the goods. It is therefore not necessary for the lien holder to take the initiative and seek to find out whether there is any company in relation to which an administration order has been made which has an interest in the goods. The position is the same under section 88 of the Act of 1982. The aerodrome authority is only concerned with a company the administrator of which is seeking to operate the aircraft. If an administrator is seeking to operate the aircraft, then he will have to identify himself to the airport authority and the airport authority will then be able to decide whether in relation to that operator it would be appropriate to apply to the court for leave. Pending a claim to operate the aircraft being put forward by an administrator, it is perfectly in order for the aerodrome authority to establish its security. It will only need to enforce that security if and when someone seeks to operate the aircraft. If that person is not a company in relation to which an administration order has been made, then the airport authority is entitled to enforce its security. If it is a company which is subject to an administration order, then the subsection envisages that the security should be able to be enforced with the leave of the administrator or the court and so it must be implicit that the detainor should have the opportunity to obtain that consent. The airport authority will not have that opportunity if it has to allow the aircraft to be operated pending an attempt to obtain the consent.

The successive interests problem

If a right to a lien has been enforced against a person otherwise entitled to possession who is not entitled to the protection of section 11 of the Act of 1986, the fact that that person assigns its interests in the goods to a company which is subject to an administration order will not mean that the lien holder in consequence of the assignment contravenes *771 section 11. It will only be necessary for the lien holder to obtain the consent of the administrator or of the court when the administrator of the company which has acquired the interest in the chattels seeks possession of the same. The position is exactly the same with regard to an aerodrome authority exercising its statutory right to detain. The fact that that statutory right has been enforced against a company which is not subject to an administration order is of no relevance in deciding whether or not steps have been taken to enforce the security in the event of an administration order subsequently being made in relation to that company or that company assigning its interest to another company which is the subject of an administration order.

It is for these reasons that I do not anticipate that in practice there should be any difficulty as a result of the interaction of the right of detention given by section 88 of the Act of 1982 and the effect of making an administration order because of section 11 of the Act of 1986. Different problems may arise if the aerodrome authority wishes to exercise its right of sale under section 88 of the Act of 1982. However, this is not a subject which it would be appropriate to consider on this appeal.

There are, however, two other points which I would make. The first is that I see a parallel between our decision on this appeal and the very recent decision of the House of Lords in *In re Smith (A Bankrupt), Ex parte Braintree District Council* [1990] 2 A.C. 215. The statutory provisions which the House of Lords had to consider were different. The House of Lords were considering the effects of bankruptcy on the imposition of a committal to imprisonment in default of paying rates. However,

the policy which Lord Jauncey of Tullichettle identified in his speech with which the other members of the House agreed in that case was similar to that identified by the Vice-Chancellor in this case and in my view the decision provides some support for our conclusion on this appeal.

The other point is that while I regard the passage from Phillips J.'s judgment in *Havelet Leasing Ltd. v. Cardiff-Wales Airport Ltd.* (unreported), 29 June 1988 cited by the Vice-Chancellor as accurately stating the law, I would not wish to be taken as approving Phillip J.'s decision on the second issue between the parties in that case. In interlocutory proceedings Hirst J. had taken a different view from Phillips J. and, as the issue does not directly arise on this appeal, I would prefer to leave the point open as it could well be that there is considerable merit in the approach of Hirst J.

STAUGHTON L.J.

I agree that this appeal should be dismissed for the reasons given by Sir Nicolas Browne-Wilkinson V.-C. However, I feel bound to add that I have misgivings as to how our decision may affect other cases in the future.

Take the case of a road haulage company in respect of which an administration order is made. At the time one of its lorries has just been repaired by a garage owner, at a cost of £1,000, and is ready for collection upon payment of the bill. The company's driver arrives to take the lorry away, but is refused delivery until the bill is paid. That, as *772 it seems to me, may be unlawful conduct on the part of the garage owner, for which there would be a remedy in damages. Yet he may not even know that an administration order has been made, although it is required to be advertised under the Insolvency Rules.

In case it be thought that the lorry driver would promptly provide that information - adding, perhaps, that the garage owner need not be deceived by [section 246 of the Insolvency Act 1986](#) into thinking that he is free to exercise his lien, because the Court of Appeal has held that [section 11\(1\)\(c\)](#) still requires the leave of the court to be obtained - let us consider a slightly different case. Suppose that the lorry is not owned by the road haulage company, but hired by it under a lease from a finance company; and that it is the finance company in respect of which the administration order has been made. Again the garage owner may not know of the administration order, and nobody may tell him about it. But he may incur liability in damages if he refuses delivery until his bill is paid.

In such cases the liability may be small. But it could be very much larger in the case of an airport that detains an aircraft which is about to leave full of passengers. No doubt airport managers will soon be aware of the hazards they face in detaining any aircraft without making all necessary inquiries as to its operator and owner; but that does not seem to me to improve their situation much.

I hope that it will indeed prove possible for garage owners or airport managers to obtain leave of the court promptly, within a matter of hours. But what of the costs involved? To obtain legal advice and assistance on an area of the law which I would regard as *recondite*, perhaps in unsociable hours, is bound to be expensive. Even if such applications are one day heard for the most part in a county court, I would imagine that the garage owner would face a bill of £500 at least, and probably more. Is it to be expected that he will recover his costs, as a matter of course, from the administrator? If not, the best advice that his solicitor could give him would be to forget his lien and deliver up the lorry forthwith.

Since writing this judgment I have had the advantage of reading the judgment which is to be delivered by Woolf L.J. It may well be that the difficulties which I foresee will be overcome in the manner which he suggests; we heard no argument about them, and I express no opinion one way or the other. For the present I consider that the effect of [section 11\(1\)\(c\)](#) should be kept carefully under review in the future. As the law stands, and as I have already said, I would dismiss this appeal.

Representation

Solicitors: Cartwrights ; Evershed Wells and Hind ; Wilde Sapte ; Beaumont & Sons .

Appeal dismissed with costs. ([Reported by MISS BARBARA SCULLY, Barrister-at-Law])

Footnotes

- 1 [Civil Aviation Act 1982, s. 88\(1\)](#) : see post, p. 755C-D
- 2 [Insolvency Act 1986, s. 11\(3\)](#) : see post p. 757E-G

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Exhibit 4

*710 Agnew and Another v Commissioner of Inland Revenue



Positive/Neutral Judicial Consideration

Court

Privy Council (New Zealand)

Judgment Date

5 June 2001

Report Citation

[2001] UKPC 28; [2001] 3 W.L.R. 454

[2001] 2 A.C. 710



Privy Council

Lord Bingham of Cornhill , Lord Nicholls of Birkenhead , Lord
Hoffmann , Lord Hobhouse of Woodborough and Lord Millett

2001 April 2, 3; June 5

Company—Debenture—Charge over book debts—Charge over uncollected book debts expressed to be "fixed"—Company able to collect and use proceeds in ordinary course of trading until crystallisation or enforcement—Whether charge fixed or floating

By a debenture dated 9 August 1995 the company created a charge, expressed to be "fixed", in favour of the bank over its book debts arising in the ordinary course of business and their proceeds, but not over such proceeds as were received by the company before the bank required them to paid into an account with itself, or before the charge crystallised or was enforced, whichever occurred first. Subject thereto the debenture created a charge, expressed to be "floating", in respect of other assets of the company and, while prohibiting the company from disposing of its uncollected book debts, permitted it to deal freely in the ordinary course of trading with assets, including the proceeds of collected book debts, which were subject to the floating charge. The company went into receivership and the receivers applied for directions as to whether the book debts which were uncollected at the time of their appointment were subject to a fixed charge, and so payable to the bank, or to a floating charge and so were available for distribution to the preferential creditors. The judge held, inter alia, that since the prohibition on alienation, whether by factoring, assignment or charge, was sufficient to create a fixed charge on the book debts, it was unnecessary also to prohibit the company from collecting them and disposing of the proceeds. He accordingly concluded that the charge was fixed. On appeal by preferential creditors, including the commissioner, the Court of Appeal reversed the judge's decision.

On appeal by the receivers—

Held, dismissing the appeal, that the critical feature which distinguished a floating from a fixed charge lay in the chargor's ability, freely and without the chargee's consent, to control and manage the charged assets and withdraw them from the security; that, since alienation and collection merely signified different ways of realising a debt, a restriction on disposal which permitted collection and free use of the proceeds enabled a debt to be withdrawn from the security by the chargor's act and was inconsistent with the nature of a fixed charge; and in consequence the prohibition on factoring or alienation of the book debts was insufficient to convert a floating charge into a fixed charge; that, irrespective of whether the debenture created a single charge or separate charges over the book debts and their proceeds when collected, it was so drafted that it

was the act of the company which turned the book debts to its own account; and that, accordingly, since the company was left in control of the process by which the book debts were extinguished and replaced by the proceeds which were freely at its disposal, the charge over the uncollected debts was floating and not fixed (post, pp 726E-H, 729D-H, 730B-D).

In re Brightlife Ltd [1987] Ch 200 and In re Cosslett (Contractors) Ltd [1998] Ch 495, CA applied .

In re New Bullas Trading Ltd [1994] 1 BCLC 485, CA overruled .

Decision of the Court of Appeal of New Zealand [2000] 1 NZLR 223 affirmed .

The following cases were referred to in the judgment of their Lordships:

*Annangel Glory Cia Naviera SA v M Golodetz Ltd [1988] 1 Lloyd's Rep 45 *711*

Biggerstaff v Rowatt's Wharf Ltd [1896] 2 Ch 93, CA

Brightlife Ltd, In re [1987] Ch 200; [1987] 2 WLR 197; [1986] 3 All ER 673

Care Shipping Corpn v Itex Itagrani Export SA [1993] QB 1; [1991] 3 WLR 609; [1992] 1 All ER 91

Colonial Trusts Corpn, In re; Ex p Bradshaw (1879) 15 Ch D 465

Cosslett (Contractors) Ltd, In re [1998] Ch 495; [1998] 2 WLR 131; [1997] 4 All ER 115, CA

Evans v Rival Granite Quarries Ltd [1910] 2 KB 979, CA

Federal Commerce and Navigation Co Ltd v Molena Alpha Inc (The Nanfri) [1979] AC 757; [1978] 3 WLR 991; [1979] 1 All ER 307, HL(E)

Florence Land and Public Works Co, In re; Ex p Moor (1878) 10 Ch D 530, CA

General South American Co, In re (1876) 2 Ch D 337, CA

Governments Stock and Other Securities Investment Co Ltd v Manila Railway Co Ltd [1897] AC 81, HL(E)

Hamilton's Windsor Ironworks, In re; Ex p Pitman & Edwards (1879) 12 Ch D 707

Hart v Barnes (1982) 7 ACLR 310

Holroyd v Marshall (1862) 10 HL Cas 191, HL(E)

Keenan Bros Ltd, In re [1986] BCLC 242

London Pressed Hinge Co Ltd, In re [1905] 1 Ch 576

New Bullas Trading Ltd, In re [1993] BCLC 1389 ; [1994] 1 BCLC 485, CA

Panama, New Zealand, and Australian Royal Mail Co, In re (1870) LR 5 Ch App 318

Salomon v A Salomon & Co Ltd [1897] AC 22 , HL(E)

Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142

Street v Mountford [1985] AC 809; [1985] 2 WLR 877; [1985] 2 All ER 289, HL(E)

Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd [1994] 3 NZLR 300

Tagart, Beaton & Co v James Fisher & Sons [1903] 1 KB 391, CA

Tailby v Official Receiver (1888) 13 App Cas 523, HL(E)

Welsh Irish Ferries Ltd, In re [1986] Ch 471; [1985] 3 WLR 610

Yorkshire Woolcombers Association Ltd, In re [1903] 2 Ch 284 , Farwell J and CA; sub nom Illingworth v Houldsworth [1904] AC 355, HL(E)

The following additional cases were cited in argument:

Atlantic Computer Systems plc, In re [1992] Ch 505; [1992] 2 WLR 367; [1992] 1 All ER 476, CA

Atlantic Medical Ltd, In re [1993] BCLC 386

Bank of Credit and Commerce International SA, In re (No 8) [1998] AC 214; [1997] 3 WLR 909; [1997] 4 All ER 568, HL(E)

CCG International Enterprises Ltd, In re [1993] BCC 580

Company (No 005009 of 1987), In re A; Ex p Copp [1989] BCLC 13

Perrins v State Bank of Victoria [1991] 1 VR 749

Pirelli General Cable Works Ltd v Oscar Faber & Partners [1983] 2 AC 1; [1983] 2 WLR 6; [1983] 1 All ER 65, HL(E)
R (British Columbia) v Federal Business Development Bank (1987) 43 DLR (4th) 188
Royal Trust Bank v National Westminster Bank plc [1996] 2 BCLC 682, CA
Westmaze Ltd, In re (unreported) 15 May 1998, David Oliver QC

APPEAL from the Court of Appeal of New Zealand

The applicants, Richard Dale Agnew and Kevin Charles Bearsley, receivers of Brumark Investments Ltd (in receivership), appealed with the leave of the Court of Appeal of New Zealand from the judgment of that court (Elias CJ, Gault and Anderson JJ) [2000] 1 NZLR 223 given on 14 October 1999 allowing an appeal by the Commissioner of Inland Revenue from Fisher J, who, by a judgment delivered on 16 February 1999 in the *712 High Court of New Zealand 19 NZTC 15, had directed that the debenture in favour of Westpac Banking Corpn created a fixed charge over the company's book debts and granted a declaration that book debts invoiced prior to the commencement of the receivership were subject to such a charge. The Court of Appeal had set aside the judgment and granted a declaration that the debenture created a floating charge over the company's book debts and that section 30 of the Receiverships Act 1993 applied.

The facts are stated in the judgment of their Lordships.

R B Stewart QC for the receivers. The sole question is whether a lender can take a fixed charge over uncollected book debts while leaving the borrower company free to use the proceeds of the book debts in the ordinary course of business. The consequence of an affirmative answer is that it would be possible to have a fixed charge of uncollected book debts which does not extend to the proceeds on collection. The crucial question is whether uncollected book debts and their proceeds are indivisible so that, by allowing the company to access and apply the proceeds for the purposes of the business, the lender's security, although expressed to be a fixed charge over uncollected book debts, is relegated to a floating charge.

It has long been settled law that a lender is entitled to take an equitable charge over all present and future book debts of the debtor: see *Tailby v Official Receiver* (1888) 13 App Cas 523. A floating charge is (i) a charge on a class of assets of a company present and future (ii) where the class would in the ordinary course of business be changing from time to time and (iii) it is contemplated by the charge that, until some step is taken by the chargee, the company might carry on its business in the ordinary way as far as concerns the particular class of assets in question: see *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284. Although such a charge was formerly assumed to be floating since it related to assets of a shifting character, a fixed charge can be taken over book debts and other circulating assets; the element which distinguishes a floating from a fixed charge is not the shifting nature of the collateral but the contractual freedom of the debtor company to manage its assets and dispose of them in the ordinary course of business free from the charge: see *In re Cosslett (Contractors) Ltd* [1998] Ch 495, *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, *In re Keenan Bros Ltd* [1986] BCLC 242 and *In re A Company* (No 005009 of 1987), Ex p Copp [1989] BCLC 13. But the court has declined to give effect to the parties' designation of a charge as a fixed charge on the basis that the debenture left the company free to collect the book debts in the normal course of its business: see *In re Brightlife Ltd* [1987] Ch 200 and *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd* [1994] 3 NZLR 300.

Although a fixed charge designation has been upheld even where the charge has left the company at liberty to receive and use collectable assets (see *In re Atlantic Computer Systems plc* [1992] Ch 505, and *In re Atlantic Medical Ltd* [1993] BCLC 386) that approach has attracted criticism (see Goode "Charges over Book Debts: A Missed Opportunity" (1994) 110 LQR 592) and the courts in general have recognised that to leave the debtor company in control of the book debts and at liberty to apply their proceeds in the ordinary course of business was fatal to a fixed charge characterisation.

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However in *In re New Bullas Trading Ltd* [1994] 1 BCLC 485 the court's conclusion, that it was open to the parties to agree on a fixed charge over book debts while uncollected and a floating charge over sums paid into a bank account, introduced a new development. The decision attracted much academic and some judicial comment: see *Royal Trust Bank v National Westminster Bank Plc* [1996] 2 BCLC 682 and *In re Westmaze Ltd (unreported) 15 May 1998*; Goode "Charges over Book Debts: A Missed Opportunity" (1994) 110 LQR 592; Alan Berg, "Charges over Book Debts: A Reply" [1995] JBL 433; Stephen Griffin, "The Effect of a Charge over Book Debts: The Indivisible or Divisible Nature of the Charge?" (1995) 46 NIQL 163; Brendan Brown, "Charges over Book Debts in the New Zealand Court of Appeal" [2000] JIBL 302 and Gregory and Walton, "Book Debt Charges—The Saga Goes On" (1999) 115 LQR 14. In all material respects the debenture in the present case is the same as in the New Bullas case: see Professor D W McLauchlan in "New Bullas in New Zealand: Round Two" (2000) 116 LQR 211. If therefore the New Bullas case is correctly decided the debenture in the present case creates a fixed charge over uncollected book debts and the appeal should be allowed.

It follows that if the parties to the debenture plainly and unambiguously identified uncollected book debts and their proceeds as separate items of property with the declared intention of constituting the former the subject of a fixed charge and the latter the subject of a floating charge then that intention should be given effect for the following reasons.

First, the question whether a charge is fixed or floating is a matter of the construction of the document which creates it in the light of the circumstances of its execution and its business objective: see Alan Berg, "Charges over Book Debts: A Reply" [1995] JBL 433 ; *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 ; *In re Brightlife Ltd* [1987] Ch 200 and the *New Bullas case* [1994] 1 BCLC 485 . While mere description of the charge as "fixed" may not operate to give the charge that status if other factors are inconsistent with that description (see *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd* [1994] 3 NZLR 300), in the present case there is no doubt that the declared intention of the parties was to create a fixed charge over all book debts while uncollected.

Secondly uncollected book debts and their proceeds are readily identifiable as distinct and separate items of property, such divisibility has been recognised in other areas of the law: see Berg; *In re Welsh Irish Ferries Ltd* [1986] Ch 471 ; *The Annangel Glory* [1988] 1 Lloyd's Rep 45 ; *In re CCG International Enterprises Ltd* [1993] BCC 580 and the *New Bullas case*.

Thirdly any conceptual difficulties in recognising that distinction should yield to the commercial objectives of the parties: see *In re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214 . The distinction recognises and confers genuine commercial advantages and benefits on the lender, who wants the best available level of security, and provides a commercially sensible and workable balance between his interests and those of the borrower to trade and utilise its trading receipts in the normal course of business: see Berg; *the New Bullas case* [1994] 1 BCLC 485 ; *In re Keenan Bros Ltd* [1986] BCLC 242 and *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 . In any event the absence of a readily identifiable *714 advantage to having a fixed charge as opposed to a floating charge over book debts would be no basis for denying the lender the status of a fixed charge over books if that had been his stipulation and the borrower had agreed: see Berg, at p 433; Goode, *Legal Problems of Credit and Security*, 2nd ed (1988) , pp 51-52 ; *Biggerstaff v Rowatt's Wharf Ltd* [1896] 2 Ch 93 ; the *Supercool case* [1994] 3 NZLR 300 and *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979 . Nevertheless if clear words are used and it was the parties' intention the courts will uphold a fixed charge over all present and future book debts of a trading company: see the *Keenan case* and *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 .

Fourthly the distinction removes potential problems if book debts and their proceeds are held to be divisible: see, in particular, Berg, at pp 458-462 and the *New Bullas case*. Academic opinion lies in favour of that decision and, in consequence, does not support the decision of the Court of Appeal in the present case: see Berg, Narev and Rubenstein, "Separation of Book Debts and their Proceeds" [1994] CLJ 225 ; Griffin, "The Effect of a Charge over Book Debts: The Indivisible or Divisible Nature of the Charge?" (1995) 46 NIQL 163 ; Watts, "Fixed Charges over Book Debts" [1999] New Zealand Review 46 and Professor McLaughlan, "New Bullas in New Zealand: Round Two" (2000) 116 LQR 211.

Fisher J correctly concluded that the distinction between uncollected book debts and their proceeds was conceptually and commercially sustainable and accurately characterised the charge of the uncollected book debts as a fixed charge, the fact that it was defeasible on the debts being collected and received by the chargor is, as he rightly held, immaterial. His judgment should be restored and the contrary decision of the Court of Appeal set aside.

CB Cato and *JH Coleman* for the Commissioner of Inland Revenue. A charge will, in law, be floating even where it is described as fixed when it is over a class of company assets both present and future which fluctuates in the ordinary course of business and allows the company to collect and deal with the proceeds of collection in the ordinary course of business and crystallises on the occurrence of certain events. The most important factor is the level of control: the essential test as to whether a charge over fluctuating assets is fixed or floating is determined by consideration of whether the borrower has the power to collect the proceeds of the debts and deal with them in the ordinary course of its business: if the borrower has that power, even where some restriction is placed on the way in which the borrower could otherwise deal with the debts (see *In re Brightlife Ltd* [1987] Ch 200), the charge is floating; if the borrower does not have that power the charge will be fixed: see *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 and sub nom *Illingworth v Houldsworth* [1904] AC 355 ; *In re Keenan Bros Ltd* [1986] BCLC 242 and *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 . The control test has been adopted in other common law jurisdictions: see the *Keenan case (Ireland)*, *R (British Columbia) v Federal Business Development Bank* (1987) 43 DLR (4th) 188 , *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd* [1994] 3 NZLR 300 (New Zealand) and *Perrins v State Bank of Victoria* [1991] 1 VR 749 . Authorities decided with little regard to the control test are wrongly decided: see *In re Atlantic Computer Systems plc* [1992] Ch 505 ; *715 *In re Atlantic Medical Ltd* [1993] BCLC 386 and Goode, "Charges over Book Debts: A Missed Opportunity" (1994) 110 LQR 592 , 598, 602. Here there is no restriction on

control and, while the critical factor is the level of control over collection in the ordinary course of business, further indicia of a floating charge are also present: namely it is a charge over book debts both present and future, over a class of assets which it is anticipated will change from time to time and it is contemplated that the borrower will be able to use the collected proceeds of the book debts in the ordinary course of business.

The decision in the *New Bullas* case is irreconcilable with prior authority. It is incorrect because the court did not apply the control test and placed undue emphasis on the structure and description of the charges. The correct approach is to determine the operative effect of the arrangement and if the intention as manifested in the labels used by the parties cannot be reconciled with the operative effect, as evidenced by applying the control test, it is the operative effect which should prevail. The *New Bullas* decision was also wrong to sanction the division of uncollected book debts from the proceeds of their collection. The correct question is whether the purportedly fixed charge is fixed by reference to the control test, not whether it is theoretically possible to have a floating charge over proceeds and a fixed charge over unrealised debts. The decision has attracted criticism: see *Royal Trust Bank v National Westminster Bank plc* [1996] 2 BCLC 682 ; Lightman and Moss, *The Law of Receivers of Companies*, 2nd ed (1994) , p 36 ; Worthington, "Fixed Charges over Book Debts and other Receivables" (1997) 113 LQR 562 and David Brown, "Charges over Book Debts: Can Lenders Have Their Cake and Eat it in Pieces?" (2000) 8 Insolvency Law Journal 50 . By contrast the *New Bullas* decision has also received support: see Berg, "Charges over Book Debts A Reply" [1995] JBL 433 ; McLaughlan, "Fixed Charges over Book Debts—New Bullas in New Zealand" (1999) 115 LQR 365 and "New Bullas in New Zealand: Round Two" (2000) 116 LQR 211 ; Watts, "Fixed Charges over Book Debts" [1999] New Zealand Law Review 46 and Naren and Rubenstein, "Separation of Book Debts and their Proceeds" [1994] CLJ 225 .

In enacting, in particular, section 30 of the Receivership Act 1993 the New Zealand legislature would have relied on the established test of control as the settled approach to the characterisation of charges. Given the importance of certainty of approach in commercial cases there should now be no radical change from that test. If the floating charge is considered inadequate to meet current commercial demands reform should be effected through amending legislation but not by departing from precedent: see *Pirelli General Cable Works Ltd v Oscar Faber & Partners* [1983] 2 AC 1 .

The judge's reasoning, in particular his distinction between a restriction on disposition to third parties of uncollected book debts and the power of the borrower to control and consume those debts, was inconsistent with established case law. He wrongly followed the decision in the *New Bullas* case and he failed to apply the correct test. The Court of Appeal was accordingly correct to reverse his decision.

Stewart QC replied.

Cur adv vult

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5 June. The judgment of their Lordships was delivered by

LORD MILLETT

1. The question in this appeal is whether a charge over the uncollected book debts of a company which leaves the company free to collect them and use the proceeds in the ordinary course of its business is a fixed charge or a floating charge.
2. The company which granted the charge in question, Brumark Investments Ltd, is in receivership. The only assets available for distribution to creditors are the proceeds of the book debts which were outstanding when the receivers were appointed and which they have since collected. If the charge is a fixed charge, as the receivers contend, the proceeds are payable to the company's bank Westpac Banking Corpn as the holder of the charge. If, however, it was a floating charge at the time it was created then, by the combined effect of Schedule 7 to the Companies Act 1993 and section 30 of the Receiverships Act 1993, they are payable to the employees and the Commissioner of Inland Revenue as preferential creditors. In a carefully reasoned judgment the judge, Fisher J (1999) 19 NZTC 15, 159, held that it was a fixed charge, but his decision was reversed by the Court of Appeal [2000] 1 NZLR 223 . A curiosity of the case is that the distinction between fixed and floating charges, which is of great commercial importance in the United Kingdom, seems likely to disappear from the law of New Zealand when the Personal Property Act 1999 comes into force.
3. The debenture is dated 9 August 1995. It is closely modelled on the instrument which was the subject of the controversial decision of the English Court of Appeal in *In re New Bullas Trading Ltd* [1994] 1 BCLC 485 and may have been deliberately drafted in order to take advantage of that decision. The relevant provisions of the debenture are set out in full in the judgments

below and their Lordships can state them shortly. It is expressed to create a fixed charge on the book debts of the company which arise in the ordinary course of trading and their proceeds, but not those proceeds which are received by the company before the charge holder requires them to be paid into an account with itself (which it could do at any time but never did) or the charge created by the deed crystallises or is enforced whichever should first occur. Subject thereto, the charge is expressed to be a floating charge as regards other assets of the company. The debenture prohibits the company from disposing of its uncollected book debts, but permits it to deal freely in the ordinary course of its business with assets which are merely subject to the floating charge; these include the money in its bank accounts and the proceeds of the book debts when collected.

4. Thus the deed purports to create a fixed charge on the book debts which were outstanding when the receivers were appointed and the proceeds of the debts which they collected. Prior to their appointment, however, the company was free to collect the book debts and deal with the proceeds in the ordinary course of its business, though it was unable to assign or factor them. The question is whether the company's right to collect the debts and deal with their proceeds free from the security means that the charge on the uncollected debts, though described in the debenture as fixed, was nevertheless a floating charge until it crystallised by the appointment of the receivers. This is a question of characterisation. To answer it their Lordships must examine the nature of a floating charge and ascertain the features which distinguish it from a fixed charge. They propose to start by *717 tracing the history of the floating charge from its inception to the present day, paying particular attention to charges over book debts.

5. The floating charge originated in England in a series of cases in the Chancery Division in the 1870s: *In re Panama, New Zealand, and Australian Royal Mail Co (1870) LR 5 Ch App 318* (generally regarded as the first case in which the floating charge was recognised), *In re Florence Land and Public Works Co; Ex p Moor (1878) 10 Ch D 530*, *In re Hamilton's Windsor Ironworks; Ex p Pitman & Edwards (1879) 12 Ch D 707* and *In re Colonial Trusts Corp; Ex p Bradshaw (1879) 15 Ch D 465*. Two things led to this development. First, the possibility of assigning future property in equity was confirmed in *Holroyd v Marshall (1862) 10 HL Cas 191*. The principle was of general application and made it possible for future book debts to be assigned by way of security: *Tailby v Official Receiver (1888) 13 App Cas 523*. Secondly, the [Companies Clauses Consolidation Act 1845](#) sanctioned a form of mortgage for use by statutory companies by which the company assigned "its undertaking". It was natural that this formula should afterwards be adopted by companies incorporated under the Companies Act 1862.

6. The debenture in *In re Panama, New Zealand, and Australian Royal Mail Co LR 5 Ch App 318* was in this form. It charged "the undertaking" of the company "and all sums of money arising therefrom". This was taken to mean all the assets of the company both present and future including its circulating assets, that is to say, assets which are regularly turned over in the course of trade. From the word "undertaking" Giffard LJ derived the inference that unless and until the charge holder intervened the parties contemplated that the company was to be at liberty to carry on business as freely as if the charge did not exist, which it would not be able to do if the circulating assets were subject to a fixed charge.

7. The thinking behind the development of the floating charge was that compliance with the terms of a fixed charge on the company's circulating capital would paralyse its business. This theme was repeated in many of the cases: see for example *In re Florence Land and Public Works Co 10 Ch D 465*, 541 per Sir George Jessel MR, *Biggerstaff v Rowatt's Wharf Ltd [1896] 2 Ch 93*, 101, 103 per Lindley and Lopes LJJ. A fixed charge gives the holder of the charge an immediate proprietary interest in the assets subject to the charge which binds all those into whose hands the assets may come with notice of the charge. Unless it obtained the consent of the holder of the charge, therefore, the company would be unable to deal with its assets without committing a breach of the terms of the charge. It could not give its customers a good title to the goods it sold to them, or make any use of the money they paid for the goods. It could not use such money or the money in its bank account to buy more goods or meet its other commitments. It could not use borrowed money either, not even, as Sir George Jessel MR observed, the money advanced to it by the charge holder. In short, a fixed charge would deprive the company of access to its cash flow, which is the life blood of a business. Where, therefore, the parties contemplated that the company would continue to carry on business despite the existence of the charge, they must be taken to have agreed on a form of charge which did not possess the ordinary incidents of a fixed charge.

8. The floating charge is capable of affording the creditor, by a single instrument, an effective and comprehensive security upon the entire *718 undertaking of the debtor company and its assets from time to time, while at the same time leaving the company free to deal with its assets and pay its trade creditors in the ordinary course of business without reference to the holder of the charge. Such a form of security is particularly attractive to banks, and it rapidly acquired an importance in English commercial life which the Insolvency Law Review Committee (1982) (*Cmnd 8558*), para 1525 later *considered* should not be underestimated. It was, however, not available to individual traders because of the doctrine of reputed ownership in bankruptcy. That doctrine did not apply to companies. It was abolished in England by the Insolvency Acts 1985 and 1986 following a

recommendation of the Insolvency Law Review Committee. It had already been abolished in New Zealand by section 42 of the Insolvency Act 1967 .

9. Valuable as the new form of security was, it was not without its critics. One of its consequences was that it enabled the holder of the charge to withdraw all or most of the assets of an insolvent company from the scope of a liquidation and leave the liquidator with little more than an empty shell and unable to pay preferential creditors. Provision for the preferential payment of certain classes of debts had been introduced in bankruptcy in 1825 and was extended to the winding up of companies by section 1(1)(g) of the Preferential Payments in Bankruptcy Act 1888. Section 107 of the Preferential Payments in Bankruptcy Amendment Act 1897 now made the preferential debts payable out of the proceeds of a floating charge in priority to the debt secured by the charge.

10. A second mischief arose from the very nature of the floating charge which allowed a company to continue to trade and incur credit despite the existence of the charge. This put the ordinary trade creditors of the company at risk, even though they would not normally know of the existence of the charge; for the holder of the charge could step in without warning at any time and obtain priority over them. Such trade creditors would include the suppliers of goods which the charge holder could appropriate to the security and realise for its own benefit leaving the suppliers unpaid. This was seen by many judges as an injustice and by Lord Macnaghten as a great scandal: see *In re General South American Co (1876) 2 Ch D 337* , 341 per Malins V-C, *Salomon v A Salomon & Co Ltd [1897] AC 22* , 53 per Lord Macnaghten and *In re London Pressed Hinge Co Ltd [1905] 1 Ch 576* , 581, 583 per Buckley J. Lord Macnaghten proposed giving the ordinary trade creditors a preferential claim on the assets of an insolvent company in respect of debts incurred within a limited time before the winding-up. More than 80 years later a recommendation along not dissimilar lines was made by the Insolvency Law Reform Committee. Neither was implemented. The remedy adopted by Parliament was to require floating charges to be registered so that those proposing to extend credit to a company could discover their existence. The requirement was introduced (in England) by section 14 of the [Companies Act 1900](#) and (in New Zealand) by section 130 of the Companies Act 1903 . It was extended (in England) by section 10(1)(e) of the [Companies Act 1907](#) and (in New Zealand) by section 89(2)(f) of the Companies Act 1933 to include all charges on book debts whether floating or fixed. The thinking behind this was presumably that debts subject to a fixed charge are still shown as assets in the company's balance sheet as "debtors" and thus appear to be available to support the company's credit. So far as the *719 ordinary trade creditors were concerned, however, the remedy provided by registration was more theoretical than real.

11. Before the introduction of this legislation the expression "floating charge", though in common use, had no distinct meaning. It was not a legal term or term of art. Now, however, it became necessary to distinguish between fixed charges and charges which were floating charges within the meaning of the Acts. Lord Macnaghten essayed the first judicial definition in *Governments Stock and Other Securities Investment Co Ltd v Manila Railway Co Ltd [1897] AC 81* , 86:

"A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes."

The concept of a proprietary interest in a fluctuating fund of assets was, of course, very familiar to Chancery judges. The similarity between the position of the holder of a floating charge and that of the beneficiaries of a trust fund has been noted by Professor Goode: see *Legal Problems of Credit and Security*, 2nd ed (1988) , pp 48-51.

12. The most celebrated, and certainly the most often cited, description of a floating charge is that given by Romer LJ in *In re Yorkshire Woolcombers Association Ltd [1903] 2 Ch 284* , 295:

"I certainly do not intend to attempt to give an exact definition of the term 'floating charge', nor am I prepared to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics that I am about to mention, but I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."

13. This was offered as a description and not a definition. The first two characteristics are typical of a floating charge but they are not distinctive of it, since they are not necessarily inconsistent with a fixed charge. It is the third characteristic which is the hallmark of a floating charge and serves to distinguish it from a fixed charge. Since the existence of a fixed charge would make it impossible for the company to carry on business in the ordinary way without the consent of the charge holder, it follows that its ability to do so without such consent is inconsistent with the fixed nature of the charge. In the same case Vaughan Williams LJ explained, at p 294:

"but what you do require to make a specific security is that the security whenever it has once come into existence, and been identified or appropriated as a security, *shall never thereafter at the will of the mortgagor cease to be a security. If at the will of the mortgagor he can *720 dispose of it and prevent its being any longer a security, although something else may be substituted more or less for it, that is not a 'specific security'.*" (Emphasis added.)

14. This was the first case to deal specifically with book debts. The question was whether a charge on uncollected book debts was a fixed charge or a floating charge so as to require registration. At every level of decision it was held to be a floating charge, the critical factor being the company's freedom to receive the book debts for its own account and deal with the proceeds without reference to the charge holder. At first instance Farwell J said, at p 288:

"If the assignment is to be treated as a specific mortgage or charge or disposition, then the company had no business to receive one single book debt after the date of it; but if, on the other hand, although not so called, *the company was intended to go on receiving the book debts and to use them for the purpose of carrying on its business*, then it contains the true elements of a floating security." (Emphasis added.)

And, at p 289:

"A charge on all book debts which may now be, or at any time hereafter become charged or assigned, leaving the mortgagor or assignor free to deal with them as he pleases until the mortgagee or assignee intervenes, is not a specific charge, and cannot be. The very essence of a specific charge is that the assignee takes possession, and is the person entitled to receive the book debts at once. So long as he licenses the mortgagor *to go on receiving the book debts* and carry on the business, it is within the exact definition of a floating security." (Emphasis added.)

Romer LJ, at p 296, and Cozens-Hardy LJ, at p 297, spoke in similar vein in the Court of Appeal, both expressly treating the company's right to go on *receiving* the book debts as inconsistent with the nature of a fixed charge.

15. When the case reached the House of Lords sub nom *Illingworth v Houldsworth [1904] AC 355*, 357-358 Lord Halsbury LC also took this to be the critical factor:

"It contemplates not only that it should carry with it the book debts which were then existing, but it contemplates also the possibility of *those book debts being extinguished by payment to the company, and that other book debts should come in and take the place of those that had disappeared.* That, my Lords, seems to me to be an essential characteristic of what is properly called a floating security. The recitals ... show an intention on the part of both parties that the business of the company shall continue to be carried on in the ordinary way—that the book debts shall be at the command of, and for the purpose of being used by, the company. Of course, if there was an absolute assignment of them which fixed the property in them, the company would have no right to touch them at all. The minute after the execution of such an assignment they would have no more interest in them, and would not be allowed to touch them, whereas as a matter of fact it seems to me that the whole purport of this instrument is to enable the company to carry on its business in the ordinary way, *to receive the book debts that were due to them*, to incur new debts, and to carry on their business exactly as if this *721 deed had not been executed at all. That is what we mean by a floating security." (Emphasis added.)

16. The jurisprudential nature of the floating charge was analysed by Buckley LJ in *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979 . By now it was evident that the classification of a security as a floating charge was a matter of substance and not merely a matter of drafting. As Fletcher Moulton LJ observed in that case, at p 993: "But at an early period it became clear to judges that this conclusion did not depend upon the special language used in the particular document, but upon the essence and nature of a security of this kind."

17. The law was settled to this effect for the next 70 years. By the 1970's, however, the banks had become disillusioned with the floating charge. The growth in the extent and amount of the preferential debts, due in part to increases in taxation and in part to higher wages and greater financial obligations to employees, led banks to explore ways of extending the scope of their fixed charges. It had always been possible to take a fixed charge over specified debts. There were two ways of doing this. A lender could take an assignment of each debt and perfect the security by giving notice to the debtor, thereby constituting the assignment a legal assignment and entitling the assignee to collect the debt itself. The debtor, having received notice of the assignment, would not obtain a good discharge by paying the assignor. But this method of dealing with a large number of book debts was commercially impractical. A bank or other financial institution is unlikely to be in a position to maintain credit control over the debts from time to time owing to its customer or to want to collect the debts itself; while giving notice to the debtors would seriously harm its customer's credit. The method commonly adopted, therefore, was for the lender to take an assignment of the debts but refrain from giving notice to the debtors until the assignor was in default. This meant that the assignment was an equitable assignment only, and debtors who paid the assignor without notice of the assignment would obtain a good discharge. In order to entitle the assignor to collect the debts, the assignee gave it authority to collect the debts on the assignee's behalf. The instrument of charge would constitute the assignor a trustee of the proceeds for the assignee and require it to account to the assignee for them.

18. There was never any doubt that the second of these two methods, like the first, was effective to create a fixed charge on the book debts. The fact that the assignor was free to collect the book debts was not inconsistent with the fixed nature of the charge, because the assignor was not collecting them for its own benefit but for the account of the assignee. The proceeds were not available to the assignor free from the security but remained under the control of the assignee.

19. It was, however, generally considered that it was not possible to take a fixed charge over a fluctuating class of present and future book debts. There were two reasons for this. One was commercial: book debts are part of the circulating capital of a business and constitute an important source of its cash flow, which makes it difficult to subject them to a fixed charge without paralysing the business. The other was conceptual. It is a characteristic of a floating charge that it is a charge on fluctuating assets, and it was assumed that a charge on fluctuating assets must therefore be a ^{*722} floating charge. The fallacy in this reasoning was exposed by Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 .

20. The case was concerned with the proceeds of book debts in the form of bills of exchange which were held for collection when the receivers were appointed. The company had purported to grant its bank a fixed charge on its book debts and a floating charge on other assets. The company was prohibited from disposing of the uncollected debts, and although it was free to collect them it was required to pay the proceeds into an account in its name with the bank. Slade J held that the critical feature which distinguished a floating charge from a fixed charge was not the fluctuating character of the charged assets but the company's power to deal with them in the ordinary course of business. He found that, on the proper construction of the debenture, the company was not free to draw on the account without the consent of the bank even when it was in credit. Accordingly, he held that the charge on the uncollected book debts and their proceeds was a fixed charge.

21. The debenture placed no express restrictions on the company's right to draw on the account, which was the company's ordinary business account, and the judge's finding in this respect has been doubted. But it was critical to his decision that the charge on the book debts was a fixed charge. He said, at p 158:

"if I had accepted the premise that [the company] would have had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit, I would have been inclined to accept the conclusion that the charge on such book debts could be no more than a floating charge."

22. The decision was followed by the Supreme Court of Ireland in *In re Keenan Bros Ltd* [1986] BCLC 242 where the company purported to grant its bank fixed charges over its present and future book debts. The debenture prohibited the company from disposing of the book debts or creating other charges over them without the consent of the bank. It allowed the company to collect the book debts, but required it to pay the proceeds into a designated account with the bank from which the company

was not to make any withdrawals without the written consent of the bank. In holding the charge to be a fixed charge, McCarthy J presciently observed, at p 247:

"It is not suggested that mere terminology itself, such as using the expression 'fixed charge', achieves the purpose; one must look, not within the narrow confines of such term, not to the declared intention of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention ..."

The critical feature which led the court to characterise the charge on the book debts as a fixed charge was that their proceeds were to be segregated in a blocked account where they would be frozen and rendered unusable by the company without the bank's written consent. As Henchy J explained, at p 246:

"It seems to me that such a degree of sequestration of the book debts when collected made those moneys incapable of being used in the ordinary course of business and meant that they were put, specifically and *723 expressly, at the disposal of the bank. I am satisfied that assets thus withdrawn from ordinary trade use, put in the keeping of the debenture holder, and sterilised and made undisposable save at the absolute discretion of the debenture holder, have the distinguishing features of a fixed charge. The charge was not intended to fasten in the future on the book debts; *it was affixed forthwith and without further ado to those debts as they were collected ...*" (Emphasis added.)

23. These cases were followed by a number of cases on the other side of the line. An Australian case was *Hart v Barnes (1982) 7 ACLR 310*, where the debenture purported to create a fixed charge on the company's future book debts, but the parties entered into a collateral agreement of the same date which allowed the company to collect the book debts and use the proceeds in its business as it saw fit. Anderson J held that the charge was a floating charge. The debenture holder could not sensibly be said to have obtained a proprietary interest by way of a fixed charge when its interest was "defeasible and capable of being destroyed by the company which is able to use the proceeds of such book debt in its business without in any way being accountable to the debenture holder for such proceeds" (see p 315). This is the other side of the coin. If the chargor is free to deal with the charged assets and so withdraw them from the ambit of the charge without the consent of the chargee, then the charge is a floating charge. But the test can equally well be expressed from the chargee's point of view. If the charged assets are not under its control so that it can prevent their dissipation without its consent, then the charge cannot be a fixed charge.

24. An English decision was *In re Brightlife Ltd [1987] Ch 200*. The company purported to grant its bank a fixed charge over its book debts both present and future and a floating charge over other assets. The company was not permitted to sell, factor or discount debts without the bank's written consent, but it was free to collect the debts and pay them into its ordinary bank account, though it was not required to do so. The case was thus distinguishable from but very similar to the *Siebe Gorman case [1979] 2 Lloyd's Rep 142* save that it was concerned with the proceeds of book debts which were still uncollected when the receivers were appointed. Hoffmann J held that, although the charge was expressed to be a fixed charge, it should be characterised in law as a floating charge. As he explained *[1987] Ch 200*, 209:

"In this debenture, the significant feature is that [the company] was free to collect its debts and pay the proceeds into its bank account. Once in the account, they would be outside the charge over debts and at the free disposal of the company. In my judgment a right to deal in this way with the charged assets for its own account is a badge of a floating charge and is inconsistent with a fixed charge."

25. In New Zealand there was *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd [1994] 3 NZLR 300*, where the facts were indistinguishable from those in the *Siebe Gorman* case. Tompkins J held that the charge was a floating charge. He held (following Hoffmann J in the *Brightlife* case) that a restriction on charging or assigning the debts was not sufficient by itself to create a fixed charge, and (not following Slade J in the *Siebe Gorman* case) that a requirement to pay the proceeds into the *724 company's account with the holder of the charge without any restriction on the company's power to use the money in the account was insufficient to do so either.

26. The *Brightlife* case was followed in *In re Cosslett (Contractors) Ltd [1998] Ch 495*, in a different context. It was concerned with the nature of a charge over plant and machinery on a building site which the chargor was free to remove from the site but only if they were not required for the completion of the works. Millett LJ said, at p 510:

"The chargor's unfettered freedom to deal with the assets in the ordinary course of his business free from the charge is obviously inconsistent with the nature of a fixed charge; but it does not follow that his unfettered freedom to deal with the charged assets is essential to the existence of a floating charge. It plainly is not, for any well drawn floating charge prohibits the chargor from creating further charges having priority to the floating charge; and a prohibition against factoring debts is not sufficient to convert what would otherwise be a floating charge on book debts into a fixed charge: see in *In re Brightlife Ltd [1987] Ch 200*, 209 per Hoffmann J. The essence of a floating charge is that it is a charge, not on any particular asset, but on a fluctuating body of assets which remain under the management and control of the chargor, and which the chargor has the right to withdraw from the security despite the existence of the charge. The essence of a fixed charge is that the charge is on a particular asset or class of assets which the chargor cannot deal with free from the charge without the consent of the chargee. The question is not whether the chargor has complete freedom to carry on his business as he chooses, but whether the chargee is in control of the charged assets."

27. The need for a requirement that the company should pay the proceeds of its book debts into the bank account which the company maintained with the holder of the charge did not cause any problem for the banks or their customers. That is what the company would normally do even in the absence of such a requirement. But the banks did not want to monitor the bank account and be required to give their consent whenever the company wished to make a withdrawal. They wanted the best of both worlds. They wanted to have a fixed charge on the book debts while allowing the company the same freedom to use the proceeds that it would have if the charge were a floating charge. With this object in view the draftsman of the charge which came before the court in the *New Bullas case [1994] 1 BCLC 485* adopted a new approach.

28. In every previous case the debenture had treated book debts and their proceeds indivisibly. Now for the first time in any reported case the draftsman set out deliberately to distinguish between them. As in the present case the debenture purported to create two distinct charges, a fixed charge on the book debts while they remained uncollected and a floating charge on their proceeds. It differed from the debenture in the present case only in that the proceeds of the debts were not released from the fixed charge until they were actually paid into the company's bank account, whereas in the present case they were released from the fixed charge as soon as they were received by the company. Their Lordships attach no significance to this distinction. The intended effect of the debenture was the same in each case. Until the charge holder intervened the company could continue to collect the debts, *725 though not to assign or factor them, and the debts once collected would cease to exist. The proceeds which took their place would be a different asset which had never been subject to the fixed charge and would from the outset be subject to the floating charge.

29. The question in *New Bullas*, as in the present case, was whether the book debts which were uncollected when the receivers were appointed were subject to a fixed charge or a floating charge. At first instance Knox J *[1993] BCLC 1389*, following the *Brightlife* case, held that they were subject to a floating charge. His decision was reversed by the Court of Appeal. Nourse LJ gave the only judgment.

30. He began by observing that, there being usually no need to deal with a book debt before collection, an uncollected book debt is a natural subject of a fixed charge; but once collected, the proceeds being needed for the conduct of the business, it becomes a natural subject of a floating charge. Their Lordships regard this as unsound: one might equally well say that unsold trading stock is a suitable subject of a fixed charge. Trading stock, that is to say goods held for sale and delivery to customers, and book debts, that is to say debts owed by customers to whom goods have been supplied or services rendered, are equally part of a trader's circulating capital. The trader does not hold them for enjoyment in specie. They provide him with his cash flow and as such are the natural subjects of a floating charge. His ability to carry on business depends upon his freedom to realise such assets by turning them into money and back again.

31. The principal theme of the judgment, however, was that the parties were free to make whatever agreement they liked. The question was therefore simply one of construction; unless unlawful the intention of the parties, to be gathered from the terms of the debenture, must prevail. It was clear from the descriptions which the parties attached to the charges that they had intended to create a fixed charge over the book debts while they were uncollected and a floating charge over the proceeds. It was open to the parties to do so, and freedom of contract prevailed.

32. Their Lordships consider this approach to be fundamentally mistaken. The question is not merely one of construction. In deciding whether a charge is a fixed charge or a floating charge, the court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it. A similar process is involved in construing a document to see whether it creates a licence or tenancy. The court must construe the grant to ascertain the intention of the parties: but the only intention which is relevant is the intention to grant exclusive possession: see *Street v Mountford* [1985] AC 809, 826 per Lord Templeman. So here: in construing a debenture to see *726 whether it creates a fixed or a floating charge, the only intention which is relevant is the intention that the company should be free to deal with the charged assets and withdraw them from the security without the consent of the holder of the charge; or, to put the question another way, whether the charged assets were intended to be under the control of the company or of the charge holder.

33. In the *New Bullas* case [1994] 1 BCLC 485 the preferential creditors argued that the charge was a floating charge because the company was indeed free to withdraw the book debts from the security, which it could do simply by collecting them and using the proceeds in the ordinary course of its business. Nourse LJ rejected this, holding that it was not correct to say that the book debts could cease to be subject to the fixed charge at the will of the company; they ceased to be subject to the fixed charge because that is what the parties had agreed in advance when they entered into the debenture.

34. Their Lordships agree with Fisher J in the present case that this reasoning cannot be supported. It is entirely destructive of the floating charge. Every charge, whether fixed or floating, derives from contract. The company's freedom to deal with the charged assets without the consent of the holder of the charge, which is what makes it a floating charge, is of necessity a contractual freedom derived from the agreement of the parties when they entered into the debenture. To find the consent in question in the original agreement would turn every floating charge into a fixed charge.

35. The decision has attracted much academic comment, much (though not all) of it hostile. Most interest, perhaps not surprisingly, has been generated by the novel attempt to separate the book debts from their proceeds: see for example Professor Goode, "Charges over Book Debts: A Missed Opportunity" (1994) 110 LQR 592; Sarah Worthington, "Fixed Charges over Book Debts and other Receivables" (1997) 113 LQR 562; Berg (per contra), "Charges over Book Debts: A Reply" [1995] JBL 433. Their Lordships will return to this aspect after they have examined the other reasons given by Fisher J for following *New Bullas* in the present case.

36. The judge considered that the critical distinction between a floating charge and a fixed charge lay in the presence or absence of a power on the part of the company to dispose of the charged assets to third parties. It was sufficient to create a fixed charge on book debts that the company should be prohibited from alienating them, whether by assigning, factoring or charging them. It was not necessary to go further and also prohibit the company from collecting them and disposing of the proceeds. Their Lordships cannot accept this. It is contrary to both principle and authority and their Lordships think to commercial sense. It is inconsistent with the actual decisions in the *Brightlife* case [1987] Ch 200 and the *Supercool* case [1994] 3 NZLR 300 and contrary to the statements of principle in virtually every case from *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 to *In re Cosslett (Contractors) Ltd* [1998] Ch 495. It makes no commercial sense because alienation and collection are merely different methods of realising a debt by turning it into money, collection being the natural and ordinary method of doing so. A restriction on disposition which nevertheless allows collection and free use of the proceeds is inconsistent with the fixed nature of the charge; it allows the debt and its proceeds to be withdrawn from the security by the act of the company in collecting it. *727

37. The judge drew a distinction between a power of disposition and a power of consumption. There is nothing, he suggested, inconsistent with a fixed charge in prohibiting the company from disposing of the charged asset to others but allowing it to exploit the characteristics inherent in the nature of the asset itself. Their Lordships agree with this, so long as the destruction of the security is due to a characteristic of the subject matter of the charge and not merely to the way in which the charge is drafted. A fixed charge may be granted over a wasting asset. A short lease, for example, is not particularly good security, but there is no conceptual difficulty in making it subject to a fixed charge. It will cease to exist by effluxion of time, but while it subsists it cannot be destroyed or withdrawn from the security by any act of the chargor. The chargee can protect itself by arranging appropriate terms of repayment so that the amount of the debt which is outstanding at any one time is commensurate with the value of the remaining security.

38. The judge gave two examples of fixed charges over assets which are defeasible at the will of the chargor. One was a charge over uncalled share capital; the other was a shipowner's lien on subfreights. With respect neither supports his argument. A charge on uncalled share capital leaves the company with the right to make calls, and this may properly be regarded as analogous to a right to collect book debts. But, as the Court of Appeal observed, such a charge is normally accompanied by restrictions on the use to which the company may put the receipts, so that the situation is analogous to that which was thought to obtain in the *Siebe Gorman case* [1979] 2 Lloyd's Rep 142 and did obtain in *In re Keenan Bros Ltd* [1986] BCLC 242. The company can collect the money, but it is not free to use it as it sees fit.

39. The common form provision in a charterparty that the ship owner has a lien on subfreights is a different matter. In England it has been held to be a registrable charge either as a charge on book debts whether fixed or floating (*In re Welsh Irish Ferries Ltd* [1986] Ch 471 and *Care Shipping Corpn v Itex Itagrani Export SA* [1993] QB 1) or as a floating charge (*Annangel Glory Cia Naviera SA v M Golodetz Ltd* [1988] 1 Lloyd's Rep 45). In none of these cases was it held to be a fixed charge, but the better view is that it is not a charge at all: see Odith, "The juridical nature of a lien on subfreights" [1989] LMCLQ 191.

40. The extent of the rights conferred by the lien was described by Lord Alverstone CJ in *Tagart, Beaton & Co v James Fisher & Sons* [1903] 1 KB 391, 395:

"A lien such as this on a subfreight means a right to receive it as freight and to stop that freight at any time before it has been paid to the time charterer or his agent; but such a lien does not confer the right to follow the money paid for freight into the pockets of the person receiving it simply because that money has been received in respect of a debt which was due for freight."

41. The lien is the creation of neither the common law nor equity. It originates in the maritime law, having been developed from the ship owner's lien on the cargo. It is a contractual non-possessory right of a kind which is sui generis. Since the subfreights are book debts and so incapable of physical possession, the lien has been described as an equitable charge: see *Federal Commerce and Navigation Co Ltd v Molena Alpha Inc (The Nanfri)* [1979] AC 757, 784 *728 per Lord Russell of Killowen. But this was a passing remark which was not necessary to the decision, and if the lien is a charge it is a charge of a kind unknown to equity. An equitable charge confers a proprietary interest by way of security. It is of the essence of a proprietary right that it is capable of binding third parties into whose hands the property may come. But the lien on subfreights does not bind third parties. It is merely a personal right to intercept freight before it is paid analogous to a right of stoppage in transitu. It is defeasible on payment irrespective of the identity of the recipient. In this respect it is similar to a floating charge while it floats, but it differs in that it is incapable of crystallisation. The ship owner is unable to enforce the lien against the recipient of the subfreights but, as Odith observes, this is not because payment is the event which defeats it (as Nourse J stated in *In re Welsh Irish Ferries Ltd* [1986] Ch 471; it is because the right to enforce the lien against third parties depends on an underlying property right, and this the lien does not give. Apart from the obiter dictum of Lord Russell in the *Federal Commerce* case, the cases in which the lien has been characterised as an equitable charge are all decisions at first instance and none of them contains any analysis of the requirements of a proprietary interest. Quite apart from the conceptual difficulties in characterising the lien as a charge, the adverse commercial consequences of doing so are sufficiently serious to cast grave doubt on its correctness. In passing from this topic their Lordships note that the decision in *In re Welsh Irish Ferries Ltd* will be reversed by Parliament by section 396(2)(g) of the Companies Act 1985 inserted by section 93 of the Companies Act 1989 when that section is brought into force.

42. Their Lordships turn finally to the questions which have exercised academic commentators: whether a debt or other receivable can be separated from its proceeds; whether they represent a single security interest or two; and whether a charge on book debts necessarily takes effect as a single indivisible charge on the debts and their proceeds irrespective of the way in which it may be drafted.

43. Property and its proceeds are clearly different assets. On a sale of goods the seller exchanges one asset for another. Both assets continue to exist, the goods in the hands of the buyer and proceeds of sale in the hands of the seller. If a book debt is assigned, the debt is transferred to the assignee in exchange for money paid to the assignor. The seller's former property right in the subject matter of the sale give him an equivalent property right in its exchange product. The only difference between realising a debt by assignment and collection is that, on collection, the debt is wholly extinguished. As in the case of alienation, it is replaced in the hands of the creditor by a different asset, viz its proceeds.

44. The Court of Appeal saw no reason to examine the conceptual problems further. They held that, even if a debt and its proceeds are two different assets, the company was free to realise the uncollected debts, and accordingly the charge on those assets (being the assets whose destination was in dispute) could not be a fixed charge. There was simply no need to look at the proceeds at all. The same point is neatly expressed in *Lightman & Moss, The Law of Receivers of Companies*, 2nd ed (1994), pp 36-37 :

"If there is a valid legal distinction to be drawn between a debt and its proceeds, then one might have thought that the two should be treated as *729 separate assets of the company, i e that the debt exists while uncollected and is extinguished by payment, at which point the company acquires a new asset, namely the moneys paid by the debtor. If this is right, then it is difficult to see why an agreement relating to dealings with one asset, namely the moneys received, should be at all relevant to the validity of the charge which existed over a different asset, namely the debt whilst it was uncollected."

45. Their Lordships agree with this to this extent: if the company is free to collect the debts, the nature of the charge on the uncollected debts cannot differ according to whether the proceeds are subject to a floating charge or are not subject to any charge. In each case the commercial effect is the same: the charge holder cannot prevent the company from collecting the debts and having the free use of the proceeds. But it does not follow that the nature of the charge on the uncollected book debts may not differ according to whether the proceeds are subject to a fixed charge or a floating charge; for in the one case the charge holder can prevent the company from having the use of the proceeds and in the other it cannot. The question is not whether the company is free to collect the uncollected debts, but whether it is free to do so for its own benefit. For this purpose it is necessary to consider what it may do with the proceeds.

46. While a debt and its proceeds are two separate assets, however, the latter are merely the traceable proceeds of the former and represent its entire value. A debt is a receivable; it is merely a right to receive payment from the debtor. Such a right cannot be enjoyed in specie; its value can be exploited only by exercising the right or by assigning it for value to a third party. An assignment or charge of a receivable which does not carry with it the right to the receipt has no value. It is worthless as a security. Any attempt in the present context to separate the ownership of the debts from the ownership of their proceeds (even if conceptually possible) makes no commercial sense.

47. The draftsman of the debenture in the present case recognised this. He purported to separate the book debts and their proceeds, but he did not attempt to separate their ownership. They were charged by the same chargor to the same chargee. It is a matter of personal choice whether one describes this as resulting in two different charges or a single charge (which is said to be convertible). The critical factor which is determinative of the nature of the charge in respect of the uncollected book debts is that the event which is said to convert the charge from a fixed to a floating charge (if there is only one) or to replace the one charge by the other (if there are two) is the act of the company.

48. To constitute a charge on book debts a fixed charge, it is sufficient to prohibit the company from realising the debts itself, whether by assignment or collection. If the company seeks permission to do so in respect of a particular debt, the charge holder can refuse permission or grant permission on terms, and can thus direct the application of the proceeds. But it is not necessary to go this far. As their Lordships have already noted, it is not inconsistent with the fixed nature of a charge on book debts for the holder of the charge to appoint the company its agent to collect the debts for its account and on its behalf. The *Siebe Gorman case [1979] 2 Lloyd's Rep 142* and *In re Keenan Bros Ltd [1986] BCLC 242* merely introduced an alternative mechanism for appropriating the proceeds to the security. The *730 proceeds of the debts collected by the company were no longer to be trust moneys but they were required to be paid into a blocked account with the charge holder. The commercial effect was the same: the proceeds were not at the company's disposal. Such an arrangement is inconsistent with the charge being a floating charge, since the debts are not available to the company as a source of its cash flow. But their Lordships would wish to make it clear that it is not enough to provide in the debenture that the account is a blocked account if it is not operated as one in fact.

49. Before their Lordships the receivers insisted that the company had no power to withdraw either the book debts or their proceeds from the security of the fixed charge. The debenture was so drafted that the company had no need to do so. The debts were automatically extinguished by collection and their proceeds never became subject to a fixed charge. But this is simply playing with words. Whether conceptually there was one charge or two, the debenture was so drafted that the company was at liberty to turn the uncollected book debts to account by its own act. Taking the relevant assets to be the uncollected book debts, the company was left in control of the process by which the charged assets were extinguished and replaced by different assets which were not the subject of a fixed charge and were at the free disposal of the company. That is inconsistent with the nature of a fixed charge.

50. Their Lordships consider that the *New Bullas case* [1994] 1 BCLC 485 was wrongly decided. They will humbly advise Her Majesty that the present appeal should be dismissed. The appellants must pay the respondents' costs before the Board.

Representation

Solicitors: Alan Taylor & Co Moon Beaver.

DECP

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Exhibit 5

***165 Celestial Aviation Trading 71 Ltd v Paramount Airways Pte Ltd.**



Positive/Neutral Judicial Consideration

Court

Queen's Bench Division (Commercial Court)

Judgment Date

11 February 2010

Report Citation

[2010] EWHC 185 (Comm)

[2010] 1 C.L.C. 165

Queen's Bench Division (Commercial Court)

Hamblen J.

Judgment delivered 11 February 2010

Aviation—Leasing—Relief against forfeiture—Jurisdiction—Discretion—Aircraft leased on eight year leases—Notices of default and termination—Relief against forfeiture not available in case of ordinary commercial aircraft lease—For relief jurisdiction to apply to contracts transferring bare possessory right for proportion of economic life of chattel major extension of existing authority—Right to terminate in respect of defaults in payment not essentially to secure payment of money—Powerful practical and policy reasons why there should be no relief jurisdiction in relation to aircraft leases—Time of the essence of payment—Relief should not be granted as a matter of discretion—Persistent defaults despite clear warning of consequences.

This was a trial of the issue whether the defendant (Paramount) was entitled to relief against forfeiture in respect of three aircraft specific lease agreements (ASLAs) entered into with the claimant (Celestial).

The ASLAs were in materially identical terms, incorporating the provisions of an Aircraft Lease Common Terms Agreement . Clause 5 of the Common Terms Agreement defined the payment obligations of Paramount, namely rent, payable monthly in advance, supplemental rent, payable month to reflect usage of the particular aircraft in the preceding calendar month, and a deposit (in cash or by letter of credit) as security for Paramount's obligations under the ASLAs. The leases were for an eight year term.

Celestial contended that from soon after delivery of each of the aircraft Paramount became late in its payments of rent and supplemental rent. That led Celestial to send to Paramount a number of notices of default. Eventually Celestial exercised its right to terminate. In the period running up to the termination notice Paramount was also in default in relation to the letters of credit provided on account of its deposit obligations under the ASLAs.

Celestial applied for summary judgment on its claim for moneys due under the ASLAs and obtained judgment in the sum of US\$791,944.54 ([2009] EWHC 3142 (Comm)). Celestial also sought delivery up of the aircraft and various declarations including a declaration that the ASLAs had been validly terminated, but Paramount contended that it should have relief from forfeiture. A trial was directed of the issues whether the court had jurisdiction to grant relief from forfeiture in relation to an aircraft operating lease of the type and on the terms ***166** of those before the court; and, if so, whether it was appropriate for the court, in the exercise of its discretion, to grant such relief.

Held , refusing the equitable relief sought by Paramount on both jurisdictional and discretionary grounds:

1. The authorities indicated that in order to determine whether there was jurisdiction to grant relief against forfeiture it was particularly relevant to consider whether the contract involved the transfer of proprietary or possessory rights; if so, whether it was possible to state that the object of the transaction and of the insertion of the right to forfeit was essentially to secure the payment of money; and/or whether the primary object of the bargain was to secure a stated result which could effectively be attained when the matter came before the court, and where the forfeiture provision was added by way of security for the production of that result; if so, whether reasons of legal policy supported the existence of such a jurisdiction. (*Shiloh Spinners Ltd v Harding* [1973] AC 691 and *The Scaptrade* [1983] 2 AC 694 applied .)

2. The ASLAs involved rental for a period of time which was substantially less than the aircraft's useful economic life and thereby the retention by Celestial of most of the risks and rewards of ownership. Whilst the ASLAs transferred possessory rights to Paramount, for the relief jurisdiction to apply to contracts transferring a bare possessory right for only a proportion of the economic life of the chattel would represent a major extension of existing authority. (On *Demand Information plc v Michael Gerson (Finance) plc* [2001] 1 WLR 155 (CA); [2003] 1 AC 368 (HL) considered .)

3. In the present case Celestial had a very real continuing interest in the aircraft themselves, not just in the payment of rent. Its expectation was that it would receive the aircraft back so as to be able to relet them or resell them and one of Paramount's primary obligations under the ASLAs was to redeliver the aircraft in the appropriate condition upon termination. In the circumstances it could not be said that this was a case where the termination provision was inserted 'essentially to secure the payment of money' or that that was the 'primary object of the bargain' with the termination provision being inserted as 'security for the production of that result'. That strongly indicated that this was not a case in which the court has relief jurisdiction. (*Shiloh Spinners* applied; *The Jotunheim* [2005] 1 Ll Rep 181 distinguished .)

4. There were powerful practical and policy reasons, in particular the need for certainty, leading to the conclusion that there should be no relief jurisdiction in relation to aircraft leases such as the ASLAs. (*Sport International Bussum BV v Inter-Footwear Ltd* [1984] 1 WLR 776 and *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514 considered .)

***167**

5. This was not one of the limited cases in which there was jurisdiction to order relief against forfeiture. In any event, as a matter of discretion, relief against forfeiture should not be granted, notwithstanding the serious consequences which Paramount might suffer if the aircraft were redelivered to Celestial. In particular, the operative defaults were knowingly committed and there was no excuse or even explanation for them. They were committed against a background of persistent defaults evidencing a cavalier disregard by Paramount for its contractual obligations and despite clear warnings of the consequences of continuing default. The defaults had still not been cured and Paramount had been in further default as well as in breach of a court order. There was real prejudice to Celestial if relief was given and it was compelled to carry on with the ASLAs. (*Goker v NWS Bank plc* (1 August 1990, CA) applied .)

The following cases were referred to in the judgment:

Afovos Shipping Co SA v R Pagnan & Fratelli (The Afovos) [1980] 2 Ll Rep 469 .
Goker v NWS Bank plc (1 August 1990, CA) .
Hill v Barclay (1811) 18 Ves Jun 56; 34 ER 238 .
Jotunheim, The [2005] 1 Ll Rep 181 .

On Demand Information plc v Michael Gerson (Finance) plc [2001] 1 WLR 155 (CA); [2003] 1 AC 368 (HL) .
Sanders v Pope (1806) 12 Ves Jun 282; 33 ER 108 .
Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade) [1981] 2 Ll Rep 425; [1983] QB 529 (CA); [1983] 2 AC 694 (HL) .
Shiloh Spinners Ltd v Harding [1973] AC 691 (HL) .
Sport International Bussum BV v Inter-Footwear Ltd [1984] 1 WLR 776 .
Steedman v Drinkle [1916] 1 AC 275 .
Stickney v Keeble [1915] AC 386 .
Transag Haulage Ltd v Leyland DAF Finance plc [1994] 2 BCLC 88 .
Union Eagle Ltd v Golden Achievement Ltd [1997] AC 514 .
Whiteley Ltd v Hilt [1918] 2 KB 808 .

Representation

Timothy Saloman QC and Nicholas Craig (instructed by Allen & Overy Llp) for the claimant.
Stephen Cogley (instructed by Andrew Jackson Solicitors) for the defendant.

JUDGMENT

Hamblen J:

Introduction and background

1. The general background to these proceedings is set out in the judgment of Teare J of 4 December 2009 ([2009] EWHC 3142 (Comm)) whereby he gave judgment for the Claimant (‘Celestial’), the owner of three Embraer 175 aircraft (‘the Aircraft’) leased to the Defendant (‘Paramount’) under three aircraft specific lease agreements *168 each dated 29 July 2005 (‘the ASLAs’), against Paramount on its application for summary judgment in respect of Celestial's claim for moneys due under the ASLAs. He gave judgment in the sum of US\$791,944.54. Further, he ordered, without prejudice to Paramount's contention that the ASLAs had been validly terminated on 14 October 2009, that various payments be made to Celestial by Paramount on an ongoing basis on various dates each month. He also ordered Paramount to permit Celestial to inspect the Aircraft (including records) by 18 December 2009; this was on account of, amongst other things, Celestial's concerns over the maintenance of the Aircraft.

2. On its application for summary judgment Celestial had also sought delivery up of the Aircraft leased under the ASLAs (and various declarations including a declaration that the ASLAs had been validly terminated). However, shortly before the hearing of Celestial's application on 24 November 2009 Paramount contended that it should have relief from forfeiture. Teare J decided that this question was arguable and gave directions for an expedited trial. At a further hearing before me on 19 January 2010 I gave further directions including an order, in light of the fact that disputes had arisen about whether Celestial had been given a proper opportunity to inspect the Aircraft, that issues relating to the maintenance and operation of the Aircraft be left to be determined, if necessary, at a further trial (to commence on 19 April 2010). The present trial concerns whether Paramount is entitled to relief against forfeiture on the basis that the only breach giving rise to the right to terminate is the failure to pay moneys due as held by Teare J.

The issues

3. There are essentially two issues for determination, namely:
- (1) Whether the Court has jurisdiction to grant relief from forfeiture in relation to an aircraft operating lease of the type and on the terms of those before the Court; and
 - (2) If so, whether it is appropriate for the Court, in the exercise of its discretion, to grant such relief.

The witness evidence

4. At the trial I heard oral evidence from four witnesses of fact, namely:

- (1) Mr M Thiagarajan—the Managing Director of Paramount (by video link);
- (2) Mr Dermot Manifold – the Vice President in Marketing Operations for General Electric Capital Aviation Services (‘GECAS’—the owner of Celestial, which is a leasing vehicle) who monitors the availability of aircraft within the GECAS fleet and identifies potential customers for aircraft; *169
- (3) Mr Adam Law – a Senior Vice President and Counsel of GECAS who was involved in the decision making processes of GECAS with respect to Paramount; and
- (4) Ms Leona Drennan – an operations associate within GECAS who was from July 2009 responsible for managing the Paramount account.

5. Celestial also served a statement from Mr Kuber Dewan—a lawyer in India who was involved in the application for deregistration lodged with the DGCA in November 2009 by GECAS, who was not required to be called.

6. Both sides also served expert reports on the effect of the Foreign Exchange Management Act 1999 in the context of the operating leases of commercial aircraft from Indian lawyers, Ms Fereshte Sethna for Celestial and Mr Rahul Balaji for Paramount. There was a large measure of agreement between the experts and it was considered unnecessary that they be called, although both sides reserved the right to comment on the other’s expert evidence.

The terms of the Aslas

7. On 29 July 2005 GECAS concluded an Aircraft Lease Common Terms Agreement with Paramount (‘the CTA’). The CTA was concluded in anticipation of Paramount concluding a number of leases with GECAS or one or more of its subsidiaries which were to be concluded on the terms of an Aircraft Specific Lease Agreement .

8. On the same day Celestial concluded the ASLAs with Paramount. The ASLAs are all, save for the scheduled delivery dates, in materially identical terms and each one expressly incorporates the terms of the CTA . The term of each of the ASLAs is eight years from the date of delivery of each of the Aircraft.

The payments required to be made by Paramount to Celestial: clause 5

9. Clause 5 of the CTA which was incorporated into each of the ASLAs defines the payment obligations of Paramount. There are essentially three types of payment that are required to be made by Paramount, namely (1) rent, being the moneys paid to lease the aircraft, (2) supplemental rent, being moneys to be paid by Paramount on account of the maintenance costs associated with the aircraft and (3) deposit, being moneys paid as security for all of Paramount’s obligations under each of the ASLAs. (There is also an obligation to indemnify Celestial in respect of any expenses incurred by it in and about enforcing or preserving its rights under the particular ASLA or in respect of repossession of the aircraft).

10. As regards (1), rent, by clause 5.3 Paramount is required to pay ‘Rent’ (being the amount agreed in each ASLA) in advance on each ‘Rent Date’ (which is the first *170 day of each ‘Rental Period’. Each Rental Period is of one calendar month duration; the first such period starts on the date that the relevant aircraft is offered for delivery to Paramount. By sub-clause (a), ‘Lessor must receive value for the payment on the Rent Date.’ In essence, by this clause Paramount is required to ensure that Celestial receives rent in advance on a monthly basis on the same date each month for each aircraft. Rent is due to Celestial pursuant to the terms of the CTA as incorporated into the ASLAs as follows:

- (1) for the aircraft with registration number MSN 17000126 VT-PAD by the latest the 9th day of each month (earlier if such was a non-business day; the Rent due being US\$217,768.30);

- (2) for the aircraft with registration number MSN 17000137 VT-PAE by the latest the 4th day of each month (earlier if such was a non-business day; the Rent due being US\$215,315); and
- (3) for the aircraft with registration number MSN 17000147 VT-PAF by the latest the 27th day of each month (earlier if such was a non-business day; the Rent due being US\$219,670.65).

11. As regards (2), supplemental rent, by clause 5.4 Paramount is required to pay 'Supplemental Rent' by the 15th day of each calendar month on account of the usage of the particular aircraft in the preceding calendar month.

12. In relation to (3), deposits, by clause 5.1 Paramount is required to pay Celestial any deposit specified in each ASLA. Further,

(1) by clause 5.13 if Paramount fails to comply with any term of any of the ASLAs ('Other Agreements' being any ASLA concluded with Paramount by Celestial) Celestial is entitled to apply part or all of the deposit against obligations owed by Paramount to Celestial (or its affiliates). Insofar as such right is exercised Paramount is required, following a demand in writing from Celestial, to restore the deposit to the level at which it previously stood.

(2) by clause 5.14 if Paramount is required or elects to provide Celestial with a letter of credit in the place of a cash deposit as security for all of Paramount's obligations, such is (at the option of Celestial) to be confirmed at Paramount's expense by the London or New York branch of a major international bank which is acceptable to Celestial (in its sole discretion). Further

(i) by sub-clause (b), the Letter of Credit so provided can, if Celestial agrees, expire before the end of the term of the ASLA ; however, if it does it is required to be 'renewed, extended or reissued and delivered to [Celestial] not later than six (6) months prior to its expiry'. **171*

(ii) by sub-clause (d), on the occurrence of an Event of Default Celestial is entitled on demand to draw down on the Letter of Credit.

13. Common to all of the types of payment that are to be made by Paramount to Celestial (viz. (1), (2) and (3)) are,

(1) by clause 5.5 all payments made by Paramount to Celestial 'will be made for value on the due date in Dollars and in immediately available funds ... by wire transfer to: BNP Paribas, London...'

(2) by clause 5.3(c) it is agreed that:

'all payments to be made by [Paramount] to [Celestial] under Lease shall be made without prior demand to [Celestial]. Without prejudice to such right of [Celestial], for facilitation purposes only before the Exchange Control Authority of India, [Celestial] agrees to remit invoices for the payments of Rent under the Lease no later than 10 days before the Rent Date. Either the non-remittance or non-receipt of any such invoice by Lessor shall not excuse or release [Paramount] of its obligation to pay Rent, which [Paramount] acknowledge and agree are absolute and unconditional obligations.'

(3) by clause 5.16 Paramount is liable, on demand from Celestial, to pay interest at a rate of six month LIBOR plus 5% (see the definition in Schedule 1 to the CTA) if it fails to pay any amount due to it on time.

14. Clause 5.12 states as follows:

'The Lease is a net lease. [Paramount's] obligations to pay Rent and to perform all of its other obligations is absolute and unconditional no matter what happens and no matter how fundamental or unforeseen the event. [Paramount] shall not regard its obligations as ended, suspended or altered in any way because of any defence, set-off, counterclaim, recoupment or other right of any kind or of any other circumstance.'

15. In addition, clause 15.6 provides as follows:

'The time stipulated in the Lease for all payments payable by [Paramount] and the prompt, punctual performance of [Paramount's] obligations under the Lease are of the essence of the Lease.'

Celestial's covenants: clause 7

16. By clause 7 of the CTA Celestial makes two covenants with Paramount which are both expressly conditional on the fact that 'no Event of Default has occurred and is continuing.' *172

(1) clause 7.1 provides: 'So long as no Event of Default has occurred and is continuing, [Celestial] will not interfere with [Paramount's] right to quiet use and possession of the Aircraft during the Term.'

(2) by clause 7.2 Celestial agrees (in circumstances where Supplemental Rent is due) 'provided no Event of Default has occurred and is continuing, [Celestial] will pay the following amounts to [Paramount] by way of contribution to the cost of maintenance of the Aircraft ...' Such payment from Celestial is only due upon receipt by it of an invoice with supporting documentation evidencing performance of the specified work by the Maintenance Performer (being a person who is (i) approved and internationally recognised by the FAA or JAA to perform maintenance/modification services on commercial aircraft and (ii) agreed by both Celestial and Paramount: see the definition in Schedule 1 to the CTA).

Paramount's covenants: clause 8

17. Paramount gives a number of undertakings or covenants to Celestial under clause 8 of the CTA . In particular:

18. By clause 8.2 it agrees to provide certain information to Celestial including, amongst other things:

(1) at 8.2(a), to provide Celestial with a Technical Report (meaning a monthly report of the Flight Hours, Cycles, Engine Flight Hours and Engine Cycles operated by the Airframe and Engines for each calendar month: see Schedule 1 to the CTA) within 10 days of the end of each calendar month. It was on the basis of this report that Celestial could calculate the amount of Supplemental Rent due for the preceding month. This Supplemental Rent became expressly due and payable on the 15th day of each month.

(2) at 8.2(b), promptly to provide Celestial with Financial Information (meaning (i) if requested by Celestial the consolidated management accounts of Paramount for the most recent financial quarter and (ii) Paramount's audited balance sheet and profit and loss statement for each year of the particular ASLA within 120 days of such year end: see Schedule 1 to the CTA).

(3) at 8.2(d), to notify Celestial of any Default (meaning any Event of Default: see Schedule 1 to the CTA).

(4) at 8.2(f), to provide Celestial with any information about the location, condition use and operation of the aircraft or concerning the business or financial affairs of Paramount as Celestial might from time to time request.

19. By clause 8.5 Paramount agrees to permit Celestial's representatives access to the aircraft (including the documentary records) at any reasonable time.

*173

20. By clause 8.10 Paramount agrees to maintain, overhaul and repair the aircraft so as, amongst other things, to ensure that it is kept in as good operating condition and repair as on delivery (subject to fair wear and tear).

21. By clause 8.11 Paramount agrees, amongst other things

(1) by sub-clause (c) not to install an engine or part from an aircraft leased under an ASLA on another aircraft owned or leased by it where an Event of Default has occurred and is continuing.

(2) by sub-clause (d) not to install any engine or part on any aircraft leased under an ASLA if an Event of Default has occurred and is continuing.

Default: clause 13

22. Clause 13.1 provides as follows:

'The occurrence of any of the Events of Default will constitute a repudiation (but not a termination) of the Lease by [Paramount] (whether the occurrence of any such Event of Default is voluntary or involuntary or occurs by operation of Law or pursuant to or in compliance with any judgment, decree or order of any court or any order, rule or regulation of any Government Entity.'

23. The Events of Default themselves are set out in Schedule 9 to the CTA and include:

- (1) a failure to make scheduled payments within two business days of the due date or non-scheduled payments within five days of the due date (a).
- (2) Paramount fails to renew any Letter of Credit within the timeframe required by clause 5.14(m(iv)).
- (3) any authorisation required by Paramount to obtain and transfer freely US dollars is 'modified in a manner unacceptable to Lessor or is withheld or is revoked, suspended, cancelled, withdrawn, terminated or not renewed, or otherwise ceases to be in full force' (f).
- (4) some event occurs which Celestial, in its reasonable opinion, believes might have a material adverse effect on the financial condition or operations of Paramount or on the ability of Paramount to comply with its obligations under the particular ASLA (1).
- (5) Paramount challenges the rights of Celestial as owner or lessor of the aircraft (i). **174*
- (6) an event of default occurs under any other agreement between Celestial and Paramount (partly, (e)).
- (7) a failure to remedy any failure of any other provision not specifically identified in schedule 9 within 10 days of being asked to do so by Celestial (b).

24. Upon the occurrence of an Event of Default, clause 13.2 provides:

'[Celestial] may at its option (and without prejudice to any of its other rights under the Lease and/or otherwise), at any time thereafter (without notice to [Paramount] except as required under applicable Law):

- (a) accept such repudiation and by notice to [Paramount] and with immediate effect terminate the leasing of the Aircraft (but without prejudice to the continuing obligations of [Paramount] under the Lease), whereupon all rights of [Paramount] under the Lease shall cease; and/or
- (b) proceed by appropriate court action or actions to enforce performance of the Lease or to recover damages for the breach of the Lease; and/or
- (c) either:
 - (i) take possession of the Aircraft ...
 - (ii) by serving notice require [Paramount] to redeliver the Aircraft to Celestial at the Redelivery Location (or such other location as [Celestial] may require.'

The outline factual history

25. The Aircraft were delivered to Paramount by Celestial as follows:

- (1) Aircraft 126 was delivered on 9 August 2006;
- (2) Aircraft 137 was delivered on 4 October 2006; and
- (3) Aircraft 147 was delivered on 27 October 2006.

26. Celestial contended that from soon after delivery of each of the Aircraft Paramount became late in its payments of Rent and Supplemental Rent. This led Celestial to send to Paramount a number of Notices of Default on account of its payment defaults. The history of defaults/Notices of Default will be addressed further below. For the present I shall focus on the immediate history leading up to the defaults giving rise to the exercise of the right to terminate in October 2009.

**175*

27. On 10 July 2009 Celestial sent Paramount a Default Notice by reason of the fact that as at that date a total of US \$821,213.42 was due and owing. This non-payment was not remedied and, accordingly, on 20 July 2009 Celestial sent a Grounding Notice to Paramount.

28. These moneys were finally paid late and in breach of contract. However, Paramount then failed to pay rent due on 27 July 2009 (for Aircraft 147) and 4 August, 2009 (for Aircraft 137) in addition to supplemental rent which should have been paid on 15 July 2009. Accordingly, on 5 August 2009 Celestial sent Paramount a further Default Notice, there being due and owing a total of US\$624,995.65 at that time (as set out in the Appendix to the Notice).

29. Paramount eventually paid this sum (with late payment interest), but then failed to pay rent due for Aircraft 147 when due on 27 August 2009 in the sum of US\$219,670.65.

30. On 2 September 2009 Celestial sent another Default Notice. This was not paid and the debt due to Celestial increased to US\$653,681.91 by 9 September 2009.

31. Thereafter Celestial sent:

- (1) a Notice of Continuing Default and Final Warning on 10 September 2009 for the continued non-payment of rent and supplemental rent amounting to US\$653,681.91.
- (2) a Grounding Notice on 16 September because, in continued breach of contract, Paramount failed to pay the moneys due.
- (3) a further Default Notice on 17 September (on account of the failure on the part of Paramount to maintain Aircraft 137 in good operating condition).
- (4) a further Grounding Notice on 24 September 2009 because the moneys due remained outstanding.
- (5) a reiteration of the Grounding Notice and Warning on 25 September 2009. This Notice made clear that US\$215,540.18 remained outstanding (some payment having been made by Paramount), that no response had been received to the Default Notice of 17 September and that there had been a failure to pay Supplemental Rent (which had been invoiced on 23 September 2009).
- (6) a Notice of Continuing Event of Default and Warning on 5 October 2009 on account of the continuing failure of Paramount to pay Supplemental Rent (totalling US\$136,951.27) due on 15 September and rent for Aircraft 147 on 25 September in the sum of US\$219,670.65 and for Aircraft 137 on 2 October in the sum of US\$215,325, as set out in Appendices A and B to the Notice. These sums remained due and owing at the time of the Termination Notice.

***176**

32. Finally, on 14 October 2009 Celestial served a Termination Notice on Paramount.

33. In the period running up to the 14 October 2009 Termination Notice Paramount was also in default in relation to the letters of credit required to be provided.

34. Celestial had agreed that Paramount could provide it with confirmed letters of credit on account of its deposit obligations under each of the ASLAs. The relevant letters of credit (issued respectively on 24 September 2008 and 17 December 2008) were all confirmed by Deutsche Bank in March 2009; one was due to expire on 24 September 2009 and the others on 17 December 2009.

35. On 5 August 2009 Ms Leona Drennan of GECAS advised Paramount that it needed to renew the letter of credit it had provided in respect of Aircraft 126, such being due to expire on 24 September 2009.

36. This request was then repeated on 10 August and 12 August with no response from Paramount; on 13 August Mr Aashish Sonawala of GECAS sought clarification from Paramount of, amongst other things, the renewal of the letter of credit and was advised the same day that 'It will be renewed as per agreement'. Thereafter, Paramount was reminded of its obligation to renew on a number of further occasions; it advised that it was under renewal, but a renewed letter of credit was not received.

37. On 11 September 2009 Celestial again asked for an update on the extension, advising that it would have to place the drawdown documentation with Deutsche Bank.

38. On 16 September 2009 Leona Drennan received by email from Paramount a swift message from Andhra Bank to Deutsche Bank (dated 15 September 2009) in which it was stated that it had been approached by Paramount to extend the validity period of the existing letter of credit and that it intended to do so on 20 September 2009. Nothing was received from Paramount on 20 September and accordingly, Ms Drennan again asked for advice as to the status of the renewal.

39. In the absence of any response from Paramount and as the security was due, imminently, to lapse, Celestial drew down on the letter of credit as it was entitled to under the ASLA for Aircraft 126. By this time, Paramount had been in breach of contract for almost six months.

40. On the evening of 24 September 2009 a further swift message was sent to Deutsche Bank by Andhra Bank advising that the letter of credit had been renewed to 22 September 2010, but for a lesser amount, as Paramount claimed the right to reduce the amount. The audited accounts required to justify such a reduction had not been provided and so, as the reduction had not been agreed, there was no entitlement so **177* to do. In addition, this letter of credit was not, in any event, confirmed by Deutsche Bank as was required by Celestial.

Jurisdiction to grant relief against forfeiture

41. There was a major issue between the parties as to whether the Court has jurisdiction to grant relief against forfeiture ('the relief jurisdiction') in relation to aircraft leases such as those in the present case. Celestial submitted that this equitable jurisdiction had never previously been held to be exercisable in relation to such leases, or any like agreements. Paramount submitted that the jurisdiction should be held to be exercisable in relation to possessory leases such as these, and relied in particular on the decision in *The Jotunheim* [2005] 1 Ll Rep 181 in which it was held to be exercisable in relation to a bareboat charter.

42. The authorities indicate that in order to determine whether there is jurisdiction to grant relief against forfeiture the following considerations are of particular relevance:

- (1) Whether the contract involves the transfer of proprietary or possessory rights—see *The Scaptrade* [1983] 2 AC 694 .
- (2) If so, whether:
 - (i) 'it is possible to state that the object of the transaction and of the insertion of the right to forfeit is essentially to secure the payment of money'; and/or
 - (ii) 'the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the Court, and where the forfeiture provision is added by way of security for the production of that result.'

– see *Shiloh Spinners Ltd v Harding (HL)* [1973] AC 691 per Lord Wilberforce at p. 722B, 723G.

(3) If so, whether reasons of legal policy support the existence of such a jurisdiction—see *The Scaptrade* per Lord Diplock at p. 703E.

43. Before considering each of these matters it is important to analyse the nature of the ASLAs and to identify their most relevant features. In relation to whether the relief jurisdiction exists I consider that the following features of particular relevance:

- (1) The leases involve transfer of possession of the Aircraft during their term to Paramount. The stated term is eight years. During the term of the leases the risks and rewards of possession and operation of the Aircraft rest with Paramount. Paramount has to bear all costs and risks associated with operating, repairing, insuring and returning the Aircraft. *178
- (2) The Aircraft were to be returned to Celestial on completion of the eight year term, unless earlier terminated. The Aircraft have a useful economic life of at least 20 years (on Paramount's evidence); 25–30 years (on Celestial's evidence). The leases were therefore for only a proportion of the economic life of the Aircraft and the residual value, reward and risk rested with Celestial.
- (3) Ownership is not transferred to Paramount at the end of the term. There is no right to purchase the Aircraft during or at the expiry of the leases.
- (4) Paramount's right to use and possession of the Aircraft is conditional in that it is stated that Celestial will not interfere with it 'so long as no Event of Default has occurred and is continuing' (cl. 7.1 of the CTA).
- (5) It is recognised in Schedule 6 to the CTA that a subsequent user of the Aircraft might need to inspect it prior to redelivery and Paramount agreed 'to cooperate reasonably at all times during the Term with Lessor Owner and/or such purchaser or such next operator in order to coordinate, assist and grant access for such inspections and/or meetings as necessary.'
- (6) Schedule 6 to the CTA sets out detailed terms governing the procedures and operating condition of the Aircraft at redelivery.
- (7) A number of clauses in the CTA indicate that redelivery and transfer back was intended to happen immediately upon termination, such as clause 12.1, 13.2(a), 13.2(c) and 13.5.
- (8) The ASLAs address in considerable detail, amongst other things, the parties' respective obligations; the time for performance of obligations; what breaches will be classified as 'Events of Default'; what an 'Event of Default' will entitle Celestial to do; how termination can be declared by Celestial and what obligations its act of termination will thereupon impose upon the lessee.
- (9) Time was stated to be of the essence for all Paramount's payment obligations (cl. 15.6).

44. The consideration provided for use of the aircraft was monthly Rent. This was payable in advance (cl. 5.3).

45. The Supplemental Rent was payable in order to build up a fund to be used to cover major maintenance events for the aircraft such as an Airframe Structural Check or Engine Refurbishment (cl. 5.4, 7.2). This was payable on the basis of past use according to rates based on the number of flight hours actually used. When the qualifying maintenance work was carried out, Paramount was entitled to be paid the costs of the work out of the accrued Supplemental Rent.

*179

46. The required deposit was to be in a substantial amount (10 months' Rent reducing in certain circumstances to a minimum of six months' Rent) (cl. 5.1). This was meant to provide security for performance of Paramount's obligations, including its redelivery obligation. The evidence was that the cost of putting the Aircraft into its required redelivery condition can be very substantial.

47. Paramount submitted that if one takes into account both Rent and Supplemental Rent, over the eight year term of the ASLAs they would be paying Celestial more than the cost of the aircraft of about US\$26 million. However, I do not accept that it is appropriate to take Supplemental Rent into account. As explained above, that was a fund to be used for major aircraft

maintenance. It was not directed at the cost of purchase of the Aircraft, nor did it include any profit. If Rent alone is taken into account then the full term payments would be in the region of US\$21 million. In any event the US\$26 figure million takes no account of finance costs and the evidence was that about 84% of the cost of the Aircraft would have been borrowed at commercial rates of interest. Nor does it include any element of profit. In any event, I accept Mr Manifold's evidence that, in common with most aircraft operating leases, the Rent payable depended on the prevailing supply and demand for aircraft of this type.

(1) *Whether the contract involves the transfer of proprietary or possessory rights*

48. The Scaptrade makes it clear that relief against forfeiture is generally limited to contracts which involve the transfer of proprietary or possessory rights—see the judgment Lord Diplock at p. 702C. That was a major reason why the House of Lords held that the jurisdiction did not arise in respect of a contract of services such as a time charter.

49. In the present case the leases do not involve the transfer of any proprietary rights. However, they do involve the transfer of possessory rights during their term. In that regard the leases are analogous to bareboat charters and in *The Scaptrade* the House of Lords expressly left open the question of the applicability of relief against forfeiture to bareboat charters (p. 704G).

50. Celestial submitted that the right to bare possession of a chattel for a term was insufficient to attract the relief jurisdiction. They stressed that the moveable property cases in which the jurisdiction has been held to exist have involved not merely a possessory right but also a proprietary or expectant proprietary right. For example:

- (1) In *Goker v NWS Bank plc* (1 August 1990, CA) the dispute concerned a ‘deferred purchase agreement’ for a car.
- (2) In *Transag Haulage Ltd v Leyland DAF Finance plc* [1994] 2 BCLC 88 the dispute concerned three hire purchase agreements each for a single vehicle. There was a right to buy each vehicle for £5 at the end of the intended three year period of the agreement. *180
- (3) In *On Demand Information plc v Michael Gerson (Finance) plc* [2003] 1 AC 368 the dispute concerned a finance lease agreements of video and editing equipment pursuant to which the lessor recouped the cost of the equipment with interest, costs and profit by the end of the three year lease period. At the end of the lease period the lessee was entitled to sell the equipment to a third party and retain 95% of the sale proceeds.
- (4) In *The Jotunheim* [2005] 1 Ll Rep 181 the dispute concerned a bareboat charter which provided a hire purchase agreement pursuant to which at the end of term of the charterparty the vessel would belong to the charterers.

51. Paramount placed particular reliance upon the judgment of Robert Walker LJ in the *Court of Appeal judgment in On Demand Information plc v Michael Gerson (Finance) plc* [2001] 1 WLR 155 . In his judgment at p. 170–171 it was stated as follows:

‘I think that Knox J could have based his decision on *Transag's* possessory rights during the currency of each of the hire-purchase agreements, as well as on its option to purchase under clause 24 once the agreement had run its course.

Those possessory rights arose under contracts but I cannot accept the submission that those rights, or the rights of *On Demand* under the finance leases, were purely contractual rights if that intensive implies that they had insufficient possessory character to meet the principles which emerge from the authorities considered above.

What was said in *Whiteley Ltd v Hilt* seems to me to be well in line with those principles. *Whiteleys* and Miss Nolan entered into a hire-purchase agreement for the hire of a piano, which Miss Nolan purported to sell to the defendant. *Whiteleys* sued the defendant for detinue or conversion, and the real issue was as to the measure of damages. Warrington LJ said [1918] 2 KB 808 , 819–820:

“The nature of the interest taken by the hirer under the agreement appears to me to be this: First, a right to retain possession of the chattel so long as she performed the conditions of the agreement. Secondly, an option to purchase the chattel exercisable by payment of the instalments provided for by the contract.”—The third right was a right of reinstatement after default under a special provision of the contract—“That, in my opinion, was the interest of the hirer. The general property in the chattel no doubt remained in the plaintiffs, but that general property in it was qualified and limited by the contractual interest conferred by the agreement upon the hirer. Now, was that interest assignable? In my opinion it clearly was.”

Contractual rights which entitle the hirer to indefinite possession of chattels so long as the hire payments are duly made, and which qualify and limit the owner's *181 general property in the chattels, cannot aptly be described as purely contractual rights.'

This part of the judgment was approved by Lord Millett in the *House of Lords judgment [2003] 1 AC 368* at paragraph 29.

52. I accept that the On Demand case provides support for the proposition that the relief jurisdiction may apply to contracts which transfer possessory rights only. However, it is to be noted that both On Demand and *Whiteley Ltd v Hilt* were treated as cases involving a right to 'indefinite' possession of the chattels.

53. A contract which allows the hirer or lessee to keep possession of the chattel indefinitely is analogous to one in which he ultimately acquires ownership. In both cases the expectation is that the lessor will not get the chattel back and the consideration payable will reflect that expectation. In the On Demand case, for example, rent was payable for a primary period of 36 months at a rate designed to recoup the lessor by the end of that period for the cost of the equipment with interest together with other costs and profit. Thereafter the lessee was entitled to indefinite possession for a nominal annual rent. In such circumstances the lessor's continuing interest in the chattel is essentially an economic one. Its interest is in payment of the rent rather than the return of the chattel. In substance it is more of a security interest than an ownership interest.

54. In the present case, by contrast, Paramount only has a right to possess the Aircraft for a proportion of its economic life. As such Celestial retains a very real interest in the Aircraft themselves, including their proper maintenance, the extent of their use, their condition, and their rental and resale value. Possession of the Aircraft will revert to it at a time when the bulk of their economic life is still to run, and there are detailed terms addressing the return of the Aircraft and their required redelivery condition. Celestial therefore retains many of the risks and rewards of ownership. Moreover, Rent was not calculated on the basis of recouping the cost of the Aircraft together with interest and profit. In such circumstances Celestial's general property in the Aircraft was not qualified or limited in the way in which it was in the On Demand case.

55. In this connection I was referred to the distinction between finance and operating leases, which is also addressed in the On Demand case at p. 158 of Robert Walker LJ's judgment as follows:

'The deputy judge quoted a passage from a statement published by the Institute of Chartered Accountants, SSAP 21, which provides a convenient explanation of how a finance lease differs from an operating lease:

“ *Background* Leases and hire-purchase contracts are means by which companies obtain the right to use or purchase assets. In the UK there is normally no *182 provision in a lease contract for legal title to the leased asset to pass to the lessee. A hire-purchase contract has similar features to a lease except that under a hirepurchase contract the hirer may acquire legal title by exercising an option to purchase the asset upon fulfilment of certain conditions (normally the payment of an agreed number of instalments). Current tax legislation provides that in the normal situation capital allowances can be claimed by the lessor under a lease contract but by the hirer under a hire-purchase contract.

Forms of lease Leases can appropriately be classified into finance leases and operating leases. The distinction between a finance lease and an operating lease will usually be evident from the terms of the contract between the lessor and the lessee. An operating lease involves the lessee paying a rental for the hire of an asset for a period of time which is normally substantially less than its useful economic life. The lessor retains most of the risks and rewards of ownership of an asset in the case of an operating lease. A finance lease usually involves payment by a lessee to a lessor of the full cost of the asset together with a return on the finance provided by the lessor. The lessee has substantially all the risks and rewards associated with the ownership of the asset, other than the legal title. In practice all leases transfer some of the risks and rewards of ownership to the lessee, and the distinction between a finance lease and an operating lease is essentially one of degree.”

56. On the basis of these definitions, the leases in the On Demand case were finance leases, whilst the leases in the present case are operating leases. In particular the ASLAs involved rental for a period of time which was substantially less than the aircraft's useful economic life and thereby the retention by Celestial of most of the risks and rewards of ownership.

57. In summary, whilst I accept that the ASLAs transfer possessory rights to Paramount, for the relief jurisdiction to apply to contracts transferring a bare possessory right for only a proportion of the economic life of the chattel would represent a major extension of existing authority.

(2) Whether: (i) 'it is possible to state that the object of the transaction and of the insertion of the right to forfeit is essentially to secure the payment of money'; and/or (ii) 'the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the Court, and where the forfeiture provision is added by way of security for the production of that result'

58. Paramount submitted that the insertion of the right to terminate in respect of defaults in payment was essentially to secure the payment of money.

59. In this connection reliance was placed in particular on the decision of Cooke J in *The Jotunheim* .

***183**

60. That case concerned a bareboat charter on an amended Barecon 89 Form by which the vessel *Jotunheim* was chartered for a period of 48 months. Part IV of the charter provided for a Hire/Purchase Agreement under which the vessel would, on expiry of the charter and provided that the charterers had fulfilled their obligations under the charter, belong to the charterers. Hire was to be paid monthly in advance at the rate of US\$15,104.17 discountless, and there was provision for payment of a US\$25,000 deposit on signing the charter and for lump sum deposits of US\$50,000 or US\$75,000 to be paid with the 6 months, 12 months and 16 months hire payments. Clause 32 of the charter provided a right of withdrawal 'in case of buyers' default for non-payment of hire moneys due to owner'. The owners withdrew the vessel for non-payment of hire. Each party then applied for summary judgment. Cooke J held that the owners were entitled to withdraw the vessel; that the court had jurisdiction to grant relief against forfeiture, but that on the facts relief would not be granted.

61. In his judgment Cooke J stated as follows at p. 188–189:

'47. It is accepted by the owners that the Court is, in principle, entitled to grant relief from forfeiture of a contract such as this, provided that the object of the transaction and of the insertion of the right to forfeit for non-payment of money is essentially to secure the payment of that money or is security for the attainment of a specific result which can be achieved through the Courts. If the contract provides for a right to retain possession of a chattel so long as the conditions of the agreement are performed, together with the right to purchase the chattel by payment of the instalments provided for by the contract, relief from forfeiture is available provided that the right of forfeiture is for either of these purposes.

...

50. Mr. Collett for the owners argued that there was no difference in principle between the position under a time charter and a demise charter for material purposes, since, as Lord Diplock said in *The Scaptrade* at p. 257, it was not possible to say that the insertion of the withdrawal clause, let alone the transaction itself, was to secure the payment of money. Hire was payable in advance to provide a fund to which owners could have access to provide the services they had contracted to provide to the charterers. Here, under this demise charter, Mr. Collett argued, hire was payable in advance to provide a fund for the owners to pay their mortgage. The key here, however, in my judgment, is the provision of services in a time charter, whereas in a bareboat charter which is also a hire/purchase agreement, the owners provide the ship in anticipation that they will do nothing further after delivery. They receive the charterers' payments and, if all goes well, transfer the vessel to the charterers on receipt of the final instalment.

51. So, although the parties differed as to whether or not the insertion of cl. 32 in the charter was essentially to secure the payment of money or the production ***184** of a stated result which could effectively be obtained when the matter came before the Court, in my judgment the demise charterers are right on this point. The demise charterers are given contractual and possessory rights in relation to the vessel during the four years of the charter, as is plain from cll. 9(a) and (b). Whilst the agreement functions both as a demise charter and as a sale agreement (see the heading to Part IV which refers to this as a hire/purchase agreement) the demise charterers do have the right to have ownership transferred to them at the end of the charter period, if there has been compliance with the conditions of the charter.

52. The essential purpose, therefore, of the right to withdraw the vessel under cl. 32 is to secure the payment of the hire for which the agreement provides and also payment of the deposits; default in the latter respect is non-performance of

other agreed terms, which is covered by cl. 32. There is both a requirement for an initial deposit payable at the outset, which is part of the purchase price and security for the fulfilment of the contract (which has nothing whatever to do with hire payments as such) and, as the contract goes on further, deposits are payable at 6 months, 12 months and 16 months, which will equally be lost to the demise charterers if the right of withdrawal is exercised. Clause 32, therefore, acts in terrorem to ensure that payments are properly made.

53. The need for availability of relief of the kind suggested here appears to be stronger in the present case than in a hire purchase or financing purchase agreement of the kind found in *Gerson*, relating to chattels, or even in leases of land where there is, of course, a statutory regime. It is of little consequence that the owners need a fund from the hire payments to discharge their mortgage. They can always sue for hire due and recover it, whilst the right to withdraw is there as a form of security to ensure performance.’

62. Paramount submitted the aircraft leases share many of the characteristics of bareboat charters and that a similar analysis applies to the termination provisions in this case. However, the ‘key’ according to Cooke J was that:

‘... in a bareboat charter which is also a hire/purchase agreement, the owners provide the ship in anticipation that they will do nothing further after delivery. They receive the charterers’ payments and, if all goes well, transfer the vessel to the charterers on receipt of the final instalment.’

63. Cooke J therefore identified the fact that the charter was also a hire/purchase agreement as a central consideration. As such, the anticipation was that the owners would do nothing after delivery apart from receive payments and transfer ownership of the vessel at the end of the charter. Their interest was therefore essentially an economic one. However, in the present case *Celestial* have a very real continuing interest in the Aircraft themselves, not just in the payment of rent. Their anticipation was that they would receive the Aircraft back so as to be able to relet them or resell *185 them and one of Paramount’s primary obligations under the ASLAs was to redeliver the Aircraft in the appropriate condition upon termination.

64. In such circumstances I do not consider that it can be said that the or the essential purpose of the termination provisions in the ASLAs was as ‘security’ for the payment of rent. An essential purpose of the termination provisions was to secure *Celestial*’s ability to be released from the ASLAs and to have the Aircraft returned in circumstances where Paramount was in default. Moreover, security under the ASLAs was provided by the requirement that a deposit be provided (in cash or by letter of credit).

65. In contrast to *The Jotunheim I* therefore do not accept that this is a case where the termination provision was inserted ‘essentially to secure the payment of money’ or that this was the ‘primary object of the bargain’ with the termination provision being inserted as ‘security for the production of that result’. If that is correct then the authoritative guidance provided in the *Shiloh Spinners* case strongly indicates that this is not a case in which the court has relief jurisdiction.

(3) *Whether reasons of legal policy support the existence of such a jurisdiction*

66. It is clear in particular from the case of *Sport International Bussum BV v Inter-Footwear Ltd [1984] 1 WLR 776* that even if a case can be shown to come within the principles set out in the *Shiloh Spinners* case it does not follow that the relief jurisdiction is exercisable. As stated by Oliver LJ at p. 785:

‘... Lord Wilberforce was contemplating that the jurisdiction exists in *some* cases where the primary object of the forfeiture is to secure a stated result, but he cannot, we think, have had it in mind that the jurisdiction was exercisable wherever the stated condition existed. It is inherent in his statement of principle that it applies only in “appropriate and limited cases” and, while it is true that he went on to consider the conduct of the applicant for relief in order to determine whether the case was an “appropriate” one, we cannot find in his speech any suggestion that he was treating “appropriate” and “limited” as synonyms ...

Thus *Shiloh Spinners Ltd v Harding [1973] AC 691*, in our judgment, establishes as a matter of decision no more than this: that one essential hall-mark of the limited cases in which the equitable jurisdiction to relieve will be exercisable is that the forfeiture clause has been inserted with the object mentioned.’

67. As was made clear in the House of Lords decision in *The Scaptrade*, it is necessary to consider whether ‘practical considerations of legal policy’ support the existence of the relief jurisdiction.

68. This point was reinforced by Oliver LJ in the *Sport International* case at p. 783–789B and especially at 788C–F: ***186**

‘The fact remains that the jurisdiction never was, and never has been up to now, extended to ordinary commercial contracts unconnected with interests in land and, though it may be that there is no logical reason why, by analogy with contracts creating interests in land, the jurisdiction should not be extended to contracts creating interests in other property, corporeal or incorporeal, there is, at the same time, no compelling reason of policy that we can see why it should be. And the fact is that the defendant in this case is seeking an extension by analogy, and an extension not based on any pressing consideration of legal policy but simply on an appeal to sympathy for what is considered to be a hardship arising from strict adherence to a bargain which is concluded with its eyes open. To quote again from Robert Goff LJ in *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] QB 529, 539:

“The question whether it should be so extended must be considered on its merits, as a matter of policy, taking into account the relatively slight assistance available to us from the authorities, though the fact that the jurisdiction has never before been extended to purely commercial transactions must surely cause us to regard the extension, which we are now invited to make, with a considerable degree of caution.”

69. In his judgment in *The Scaptrade* at p. 703G Lord Diplock approved and incorporated the practical and policy objections identified by Robert Goff LJ in his judgment in that case.

70. In *The Scaptrade* [1983] QB 529 Robert Goff LJ stated as follows at 540:

‘It is of the utmost importance in commercial transactions that, if any particular event occurs which may affect the parties’ respective rights under a commercial contract, they should know where they stand. The court should so far as possible desist from placing obstacles in the way of either party ascertaining his legal position, if necessary with the aid of advice from a qualified lawyer, because it may be commercially desirable for action to be taken without delay, action which may be irrevocable and which may have far-reaching consequences. It is for this reason, of course, that the English courts have time and again asserted the need for certainty in commercial transactions—for the simple reason that the parties to such transactions are entitled to know where they stand, and to act accordingly.’

71. A more recent authoritative statement to similar effect in the context of the relief jurisdiction can be found in Lord Hoffmann’s judgment in *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514 at 518H–519E and at 519F:

‘The principle that equity will restrain the enforcement of legal rights when it would be unconscionable to insist upon them has an attractive breadth. But the reasons why the courts have rejected such generalisations are founded not merely upon authority (see per Lord Radcliffe in ***187** *Campbell Discount Co Ltd v Bridge* [1962] AC 600, 626) but also upon practical considerations of business. These are, in summary, that in many forms of transaction it is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this would be “unconscionable” is sufficient to create uncertainty. Even if it is most unlikely that a discretion to grant relief will be exercised, its mere existence enables litigation to be employed as a negotiating tactic. The realities of commercial life are that this may cause injustice which cannot be fully compensated by the ultimate decision in the case.

The considerations of this nature, which led the *House of Lords in The Scaptrade* [1983] 2 AC 694 to reject the existence of an equitable jurisdiction to relieve against the withdrawal of a ship for late payment of hire under a charterparty, are described in a passage from the judgment of Robert Goff LJ in the *Court of Appeal* [1983] QB 529, 540–541, which was cited with approval by the House [1983] 2 AC 694, 703–704. Of course the same need for certainty is not present in all transactions and the difficult cases have involved attempts to define the jurisdiction in a way which will enable justice to be done in appropriate cases without destabilising normal commercial relationships.’

72. I consider that the ASLAs are transactions in respect of which the need for certainty is very much present. As Celestial submitted, commercial certainty is an important consideration in respect of an operating lease of an aircraft in which the lessor maintains a valuable reversionary interest. An aircraft is a valuable asset, with high value components, which is of its very nature ‘moveable’ and depreciating, which is left in the hands of the other party in a foreign country where it will be registered for the purpose of the lease (and need to be deregistered to be operated elsewhere). The lessor, having a reversionary right to the asset, needs to know and agree with precision with the lessee: (a) the obligations of each party, (b) the events that will entitle to lessor to terminate the contract and recover its asset and (c) provisions which will show how, as a matter of business practicality, the contract will be terminated, the asset recovered and possession returned by the lessee to the lessor.

73. The consequence of the relief jurisdiction being exercisable in cases such as the present is likely to be to make it open to any lessee of a commercial aircraft under an English law operating lease such as the ASLAs to contend that relief from forfeiture can be granted. As was borne out by Celestial's evidence, there are many such leases and this is likely to cause significant uncertainty in the aviation sector: the lessor will not know when (or indeed whether) it can terminate a lease and will be prevented from being able to rely timeously or at all on the clear and detailed default and termination provisions of its leases.

74. In my judgment these constitute powerful practical and policy reasons why there should be no relief jurisdiction in relation to leases such as the ASLAs.

***188**

75. Celestial stressed two further reasons why this was not one of those ‘appropriate’ and ‘limited’ cases in which the relief jurisdiction should be available. These were reasons of a juristic rather than a practical nature, namely: the fact that the parties made time of the essence and the fact that the termination provision is not penal.

Time of the essence

76. Celestial submitted that equity does not intervene to relieve a party from the termination of a contract for a failure by that party to perform an obligation by a fixed date where the parties have made time of the essence expressly or by necessary implication.

77. In this connection reliance was placed on a number of cases concerning contracts for the sale of land and in particular:

(1) *Stickney v Keeble* [1915] AC 386 at 416 per Lord Parker:

‘... this maxim [that the time fixed for completion in a contract for the sale and purchase of real property] is not of the essence never had any application to cases in which the stipulation as to time could not be disregarded without injustice to the parties, when, for example, the parties, for reasons best known to themselves, had stipulated that the time fixed should be essential, or where there was something in the nature of the property or the surrounding circumstances which would render it inequitable to treat it as a non-essential term of the contract.’

(2) *Steedman v Drinkle* [1916] 1 AC 275 at 279 per Viscount Haldane:

‘As to the relief from forfeiture, their Lordships think that the Supreme Court was right in holding, for the reasons assigned in the former decision of this Board, that the stipulation in question was one for a penalty, against which relief should be given on proper terms. But as regards specific performance they are of opinion that the Supreme Court was wrong in reversing the judgment of Newlands J. Courts of Equity, which look at the substance as distinguished from the letter of agreements, no doubt exercise an extensive jurisdiction which enables them to decree specific performance in cases where justice requires it, even though literal terms of stipulations as to time have not been observed. But they never exercise this jurisdiction where the parties have expressly intimated in their agreement that it is not to apply by providing that time is to be of the essence of their bargain. If, indeed, the parties, having originally so provided, have expressly or by implication waived the provision made, the jurisdiction will again attach.’

78. These authorities were affirmed in the Union Eagle case in which Lord Hoffmann, giving the judgment of the Privy Council, reaffirmed the ‘principle that in cases of rescission of an ordinary contract of sale for land for failure to comply with an essential condition as to time, equity will not intervene’ (at p. 523).

***189**

79. I accept that these cases make it clear that the relief jurisdiction is not available in relation to contracts for the sale of land where time is made of the essence. I also accept that the fact that the ASLAs made time of the essence of payment supports the conclusion that there is no relief jurisdiction. However, I do not accept that the mere inclusion of a time of the essence provision necessarily excludes the relief jurisdiction.

80. As Lord Hoffmann stated at p. 722F of the Union Eagle case in relation to mortgages ‘relief against forfeiture of the estate would ordinarily be granted as of course despite an express term that time was of the essence’. Further, the Goker v NWS Bank case involved a time of the essence provision and in The Jotunheim Cooke J took the view that time had been made of the essence—see paragraph 33 of the judgment. In both those cases a jurisdiction to grant relief was recognised.

No forfeiture

81. Celestial submitted that clause 13.2 should not be regarded as a forfeiture clause as it is not penal in nature and confers no windfall on them. In particular:

(1) Paramount never made any payment that can be described in a legal or business sense as a part payment against the price of the Aircraft. Accordingly, whenever (the ASLAs having come to their end) Paramount has to return the Aircraft to Celestial, Paramount has no continuing interest in the Aircraft. The termination and redelivery of the Aircraft do not deprive Paramount of any such interest (which it never bargained for). Paramount's sole right under the ASLAs was nothing more than a right to possession and use during the currency of the ASLAs.

(2) This contractual scheme is borne out by clause 14.2 of the CTA . Pursuant to this clause Celestial is permitted, without the consent of Paramount, to transfer any of its rights or obligations under the ASLAs or any of its rights, title or interest in the Aircraft pursuant to (amongst other things) (i) a sale and leaseback, i.e. a situation in which Celestial itself becomes a lessee; (ii) a novation of the particular ASLA together with a sale of the Aircraft; and (iii) a secured loan financing. This makes it clear that the reversionary interests were exclusively Celestial's and not Paramount's.

(3) In these circumstances, under the ASLAs Celestial does not receive any windfall on termination and Paramount is not penalised. The only right that termination destroys is Paramount's right to future possession and use.

(4) Possession of the Aircraft was always going to be given back to Celestial; if the ASLAs had run their course (without any default on the part of Paramount) that would be upon the expiry of the 8 year term. The only difference between termination for breach and termination by virtue of the contracts coming naturally to their end is the timing at which Paramount's right to possession is at an end. That is not a windfall for Celestial and nor is it a penalty for Paramount. ***190**

(5) The payments made by Paramount on account of rent and supplemental rent represent the agreed rate for use of the aircraft up to the point of termination (and no more). Paramount is not paying, for example, in addition to rent instalments against a purchase price to be completed when the final instalment is paid and it does not ‘forfeit’ any moneys on termination. It is the situation which is identical to that pertaining in The Scaptrade ; as Lord Diplock stated in that case at 702–3:

‘Moneys paid by the charterer prior to the withdrawal notice puts an end to the contract or services represent the agreed rate of hire for services already rendered, and not a penny more.’

(6) Accordingly, there being no true ‘clause of forfeiture’ or ‘forfeiture in fact’ there is no jurisdiction.

82. I accept that the fact that no significant advance payments, and in particular advance payments for the purchase of the aircraft, are forfeited on termination is a further reason for there being no relief jurisdiction. However, I do not accept that in itself it means that there is no jurisdiction. The loss of the right to continued possession of the aircraft for the substantial remaining term of the leases on a single default in payment can be regarded as involving forfeiture. This is borne out by the authorities which recognise that loss of a right of possession may be sufficient to engage the forfeiture jurisdiction.

83. For all these reasons, even if this was a case which could be shown to come within the principles set out in the Shiloh Spinners case, I am satisfied that reasons of legal policy, and in particular the need for certainty, lead to the conclusion that there is no relief jurisdiction in respect of aircraft leases such as the ASLAs.

Conclusion on jurisdiction

84. For the reasons outlined above I am not satisfied that this is one of those ‘appropriate’ and ‘limited’ cases in which the Court should hold that there is a jurisdiction to grant relief against forfeiture.

Discretion

85. If I am wrong in my conclusion on jurisdiction, the question which then arises is whether as a matter of discretion relief against forfeiture should be granted.

86. In the Shiloh Spinners case at p. 723 Lord Wilberforce stated that whether it was appropriate to grant relief involves:

‘a consideration of the conduct of the applicant for relief, in particular whether his default was wilful, of the gravity of the breaches and of the disparity between *191 the value of the property of which forfeiture is claimed as compared with the damage caused by the breach.’

87. By way of examples of the manner in which the Courts have exercised their jurisdiction in the context of commercial transactions involving moveable property, I was referred in particular to The Jotunheim and the Transag cases, and the first instance decisions of Lloyd J in The Scaptrade [1981] 2 Ll Rep 425 at 430–431 and The Afivos [1980] 2 Ll Rep 469 at 480).

The conduct of the applicant and the gravity of the breaches

88. An essential matter to be considered is the conduct of the applicant in relation to the breaches which have given rise to the right of forfeiture and the gravity of those breaches.

89. The financial defaults in respect of which the Termination Notices were served and which Teare J held to be established were as follows:

<i>Aircraft 126</i>		
<i>Date Due</i>	<i>Description</i>	<i>Amount due</i>
15-Sep-09	Supplemental Rent: 01 August 2009 to 31 August 2009	\$71,698.57
30-Sep-09	Late Payment Interest 31-Aug-09 to 30-Sep-09	\$550.16
09-Oct-09	Rent 9-Oct-09 to 08-Nov-09	\$217,768.30

<i>Aircraft 137</i>		
<i>Date due</i>	<i>Description</i>	<i>Amount due</i>
02-Oct-09	Rent: 4 October 2009 to 3 November 2009	\$215,325.00
30-Sep-09	Late Payment Interest 31-Aug-09 to 30-Sept-09	\$654.35

<i>Aircraft 147</i>		
<i>Date due</i>	<i>Description</i>	<i>Amount due</i>
15-Sep-09	Supplemental Rent: 01 August 2009 to 31 August 2009	\$65,252.70
25-Sep-09	Rent: 27 September 2009 to 26 October 2009	\$215,670.65

30-Sep-09	Late Payment Interest 31-Aug-09 to 30-Sept-09	\$1,024.81
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90. There were therefore significant sums due in respect of each Aircraft. In respect of Aircraft 126 and Aircraft 127 there were outstanding sums due in respect of both Rent and Supplemental Rent. By the time of the Termination Notices the Rent for Aircraft 137 and Aircraft 147 had been due for about two weeks, and the Supplemental Rent in respect of Aircraft 126 and Aircraft 147 had been due for nearly *192 a month. All these outstanding sums had been the subject of a Notice of Continuing Event of Default and Warning on 5 October 2009. This Notice included a warning in bold, large type as follows:

‘HOWEVER, your continued and persistent defaults regarding payments and the matters set out below are very alarming and we cannot continue to tolerate this sort of delinquency and we hereby warn you that if they are not rectified in full and as a matter of utmost urgency as soon as possible, we will be forced to take further action which may include, without limitation, termination of your right to lease the aircraft and/or court action.’

91. No proper explanation was given by Paramount as to how and why these defaults occurred, notwithstanding the length of time that the sums had been outstanding and the warnings which had been given. In his witness statement, Mr Thiagarajan said that Paramount was trying its best to comply with the payment terms of the lease but that Celestial was making it difficult. He referred to the fact that on 24 September 2009 Celestial drew down on one of the letters of credit, but, as set out earlier in the judgment, Paramount had ample warning of the need to provide an appropriate replacement letter of credit. He also referred in his statement and oral evidence to financial difficulties resulting from the fact that one of the Aircraft had been grounded for a number of months due to engine problems, Paramount's lack of a spare engine and its inability to secure a replacement. Paramount's attempts to blame Celestial for these difficulties was considered and dismissed by Teare J in his judgment at paragraphs 16 to 18.

92. This is not therefore a case where the default in question arose by surprise, accident or ignorance. Paramount knew what its obligations were and knew that it was going to default on those obligations.

93. In both *The Afovos* and *The Scaptrade Lloyd J* regarded the fact that the breach involved the fault of the applicant as being a telling factor against the grant of relief. It is clear that wilful breaches will only exceptionally be relieved against.

94. As Lord Wilberforce stated in the *Shiloh Spinners* case at p. 725:

‘Established and, in my opinion, sound principle requires that wilful breaches should not, or at least should only in exceptional cases, be relieved against, if only for the reason that the assignor should not be compelled to remain in a relation of neighbourhood with a person in deliberate breach of his obligations.’

95. Celestial submitted that ‘wilful breaches’ are all those breaches which occur not by surprise, accident or ignorance (see the recitation of the judgment of Lord Erskine LC in *Sanders v Pope* (1806) 12 Ves Jun 282 per Lord Wilberforce at 722–723 in *Shiloh Spinners* discussing the effect of *Hill v Barclay* (1811) 18 Ves Jun 56).

*193

96. The findings I have made as to the circumstances giving rise to the defaults and the knowledge with which they were made are therefore powerful grounds for denying relief.

97. Moreover, Paramount's conduct in relation to the defaults giving rise to the Notice of Termination needs to be considered in context. That context includes a long history of defaults. The immediate history of Default Notices has been set out earlier in my judgment. However, there was also a prior history of such defaults and Notices. In particular:

- (1) A Notice of Continuing Default and Warning on 24 April 2007 on account of the failure to pay the amounts demanded in the Notice of 13 April.
- (2) A Grounding Notice on 9 May 2007 by reason of the continued failure to make the payments previously demanded.
- (3) A Notice of Rescindment and Final Warning on 14 May 2007 acknowledging the fact that Paramount had remitted US\$974,870.09 and giving Paramount 2 days grace for the moneys to be received by Celestial.
- (4) A Notice of Event of Default on 26 July 2007, there being a total of US\$513,909.50 overdue.

- (5) A Notice of Continuing Event of Default and Warning on 1 August 2007 on account of the failure to pay the amounts demanded in the Notice of 26 July and advising that the total amount outstanding was US\$737,656.24.
- (6) A Notice of Event of Default on 23 August 2007, Paramount having failed (a) to pay rent and supplemental rent when due, there being US\$498,816.06 overdue and (b) to renew the confirmed letters of credit provided in respect of Aircraft 137 and Aircraft 147.
- (7) A Warning Notice on 30 August 2007 on account of Paramount's failure (a) to pay the rent in the sum of US \$217,768.30 for Aircraft 126 (due on 9 August 2007); and (b) to renew the confirmed letters of credit for Aircraft 137 and Aircraft 147. It was made clear in this Notice that Celestial reserved the right, given that these matters were Events of Default under the relevant ASLAs, to draw down on the existing letters of credit and to terminate the leases. Attached to this document was a copy of Paramount's 'Delinquency Trend' over the previous 12 months which document showed, 'your payment record has been consistently poor and has been getting worse.'
- (8) A Default Notice on 18 September 2007, on account of Paramount's failures (a) to pay rent totalling US\$433,120.30, (b) to provide monthly utilisation reports (as *194 required by clause 8.2(a) of the CTA) and to pay estimated supplemental rent totalling US\$150,000, (c) to pay late payment interest in the sum of US\$5,161.68 and (d) to renew the confirmed letter of credit in respect of Aircraft 147.
- (9) A Notice of Continuing Event of Default and Warning on 21 September 2007 on account of the failure to pay all of the amounts set out in the notice dated 18 September 2007.
- (10) A Warning Notice on 28 September 2007 advising that despite all previous warnings Paramount continued to be delinquent in its payments and advising that any further payment events of default would result in a draw down on the letters of credit.
- (11) A Notice of Event of Default on 19 October 2007, there being a total of US\$268,649.83 overdue.
- (12) A Notice of Event of Default on 25 October 2007, there being a total of US\$208,458.50 overdue.
- (13) A Notice of Event of Default on 1 November 2007, there being a total of US\$408,301.70 overdue.
- (14) A Notice of Continuing Default and Warning on 5 November 2007 on account of the failure to pay all of the amounts set out in the notice dated 1 November 2007 and further amounts becoming overdue. The total amount which Paramount had failed to pay Celestial amounted to US\$624,736.54.
- (15) A Grounding Notice on 7 November 2007 on account of the failure of Paramount to pay in full the outstanding amounts owed to Celestial.
- (16) A Notice of Event of Default on 3 December 2007, there being a total of US\$465,881.74 overdue and Paramount having failed to provide technical reports (in accordance with clause 8.2(a) of the CTA) by the 10th day of the month.
- (17) A Notice of Event of Default on 12 December 2007, there being a total of US\$436,217.48 overdue.
- (18) A Notice of Default and Warning on 7 January 2008, there being a total of US\$1,090,993.10 overdue.
- (19) A Notice of Continuing Event of Default on 14 January 2008, Paramount having failed to cure the defaults identified in the Notice of 7 January 2008 (a total of US\$587,732.33 remaining due to be paid). *195
- (20) A Further Notice of Continuing Event of Default and Warning on 21 January 2008, Paramount still having failed to pay all amounts overdue (a total of US\$519,964.03 remained due to be paid).
- (21) An Event of Default Notice on 22 December 2008, there being a total of US\$721,160.82 overdue.

98. Further, as set out in the Schedules attached to Celestial's Statement of Case, since August 2008:

- (1) Paramount had never paid Rent on time for any of the Aircraft. This is notwithstanding the fact that it was provided in each case with an invoice prior to the due date under each of the ASLAs. Each payment of rent was made on average almost two weeks (14 days) late.
- (2) Paramount had never provided a Utilisation Report for any of the Aircraft on time (i.e. by the 10th day of each calendar month).
- (3) Paramount had never paid Supplemental Rent on time for any of the Aircraft (save for a single occasion with respect to Aircraft 147). The average delay in making this payment was more than 18 days.

99. The defaults giving rise to the Termination Notice have to be viewed against this background of persistent default. Paramount stressed that all these historic defaults were cured and that interest was paid on late payments, but that does not explain or excuse the breaches. Paramount's attitude, as borne out by this history and by Mr Thiagarajan's oral evidence, appears to have been that it does not much matter if they are in default of their obligations, provided that they put that right within a reasonable time. This involves a 'cavalier disregard' of their contractual obligations, and moreover of obligations which are stated to be of the essence (cl.15.6) and to involve a repudiation if breached (cl.13.1).

100. Further, Paramount was given ample warning of the consequences of continuing default. Aside from the warnings given in Celestial's various Notices, including in particular the Notice of 5 October 2009, in a letter from Mr Sonawala of GECAS

on 13 August 2009 had set out the various points that needed to be addressed by Paramount (including the need for prompt payment going forward and the renewal of the letter of credit) and concluded,

‘Mr Thiagarajan, as you can see we are at a very important juncture here and we need your focus and commitment behind the Airline. The continuous late payments to us and several of your vendors is concerning and we need to be assured that in order to support [to] you there is adequate commitment and equity being deployed to the Airline by its promoters. There are many ways we can support you and help you to grow. However, Paramount needs to ensure that *196 fulfilment of its obligations to GECAS in whatever respect are fulfilled on a timely basis and within the timeframes set out in the Lease Agreements.’

101. This background of persistent default despite warnings makes the defaults which led to Celestial's Notice of Termination on 14 October 2009 all the more difficult to justify and excuse and is a further compelling reason for refusing relief.

102. In considering Paramount's conduct it is also important to have regard to what has happened since the operative defaults and whether they have been, can be or will be cured. The fact of the matter is that those sums have still not been paid, nor have any further sums due been paid, even though Paramount has had continuing use of the Aircraft pursuant to the Order of Teare J and despite the Court Order that further sums be paid.

103. Paramount contended that were it not for the draw down under the two letters of credit issued by State Bank of India (confirmed Deutsche Bank AG) on the 15 of December 2009, Paramount would have paid the sums due. They said that this drawdown resulted in Paramount's bankers refusing to make payment of the sums due on that date and thereafter payment cannot be made because of the bank's view of its obligations under the Foreign Exchange Management Act 1999 . This requires the bank to be satisfied that the payments can be made. The bank, which is the certifying authority for exchange control purposes, is treating the demand on the letter of credit as a discharge of the sums that would otherwise be paid, and in any event refusing to make further lease payments as Celestial asserts the leases have been terminated.

104. Further, the bank has confirmed that it would make the payments, and reconstitute the letter of credits, if the drawdown sums were returned, but Celestial has indicated that it would not return the drawdown sums. They submitted that the evidence therefore demonstrates that Paramount had sufficient funds, notwithstanding the drawdown of the letters of credit, to make the payments and that it is prevented from doing so by virtue of the position taken by the bank and Celestial's unwillingness to help break the logjam.

105. I accept that the evidence shows that Paramount did have sufficient funds to make the payments and that, since the drawdown sums exceed the sums outstanding, if Celestial co-operated a means could be found whereby those payments are made. However, Celestial is under no obligation so to do. It is standing on its strict contractual rights, as it is entitled to do, and might reasonably be expected to do in the adversarial situation which now exists between the parties.

106. Moreover, the difficulty in which Paramount now finds itself could have been avoided had it not left arrangements for making the payments until the very end, the evidence of Mr Thiagarajan being that it was left to 15 December 2009. Further, the risk of being unable to make payment due to lack of bank authorisation is not only a *197 risk which Paramount assumed under the ASLAs but the failure to obtain the requisite authorisation is itself an Event of Default (Schedule 9(f)(i)).

107. Although this further breach was not intentional it does therefore involve both fault on the part of Paramount and an inability to perform for reasons for which they are contractually responsible. This further breach, and the fact that it involves a breach of the Court Order, is a further reason for refusing relief.

Disparity

108. Paramount's essential point in relation to the exercise of discretion is the disparity between the damage caused by their breach and the damage which termination will cause.

109. Lord Wilberforce's description of the relevant disparity to be considered focuses on the value of the proprietary and/ or possessory rights which will be lost, rather than the factual consequences of their loss. However, I am prepared to have regard to these wider considerations, as Knox J did in the Transag case (p. 102 at (g)).

110. Paramount's evidence was that the loss of the Aircraft would be catastrophic for them. The Aircraft comprise 3/5 of its fleet. There are no replacements available in the market. It would lose its DGCA licence as its number of aircraft would fall below the minimum number required. This would result in the aircraft being grounded, significant inconvenience to

thousands of passengers who have bookings with Paramount and the crippling of the air transportation system in Southern India in which Paramount is a market leader. Paramount itself would be unlikely to survive and may well go into liquidation. That would mean the jobs of 2,200 direct and indirect employees being threatened.

111. This evidence was not sought to be challenged and I accept that there is a real risk of very serious consequences for Paramount, its employees and its customers if they lose the Aircraft. There was an issue as to how long it would take to find replacements but it would appear that these specialised aircraft cannot be easily or speedily replaced.

112. Paramount submitted that that is to be contrasted with the lack of prejudice which will be suffered by Celestial if relief is given. Celestial will get paid the outstanding amounts due and Paramount is willing and able to perform the ASLAs going forwards. Further, on Celestial's own evidence the replacement leases that it has conditionally arranged are on less favourable Rent terms.

113. Paramount further submitted that Celestial would receive a windfall unless relief was given as they would keep all the Rent and Supplemental Rent so far *198 paid under the ASLAs, which amounts to about US\$9 million and US\$4.5 million respectively which is close to 50% of the capital cost of the Aircraft.

114. As already explained, I do not accept that any windfall is involved. The Rent was agreed based on market considerations and reflects the agreed consideration for Paramount's use to date of the Aircraft. The Supplemental Rent is to a fund to cover major maintenance costs and does not involve a profit or windfall.

115. Nor do I accept that the prejudice to Celestial in being held bound to continue with the ASLAs is negligible, as Paramount submitted. The background of persistent default by Paramount suggests that the claim made of compliant performance hereafter should be approached with some scepticism. Whilst Paramount says it presently has the financial resources to perform, past history indicates that that is no guarantee of performance. Further, the financial difficulties which it claims it suffered through loss of the use of one Aircraft suggests shallow financial foundations which could again be shaken if anything similar recurs.

116. It is clear that Celestial has run out of patience with Paramount's persistent defaults and is determined, if it can, to recover its Aircraft and let them out to more reliable contractual partners. This is borne out by the fact that it would prefer to let the Aircraft out to another party at an appreciably lower Rent than continue with the ASLAs.

117. Given that this is Celestial's preferred course of action, and given Paramount's history of default, I consider that the most likely outcome if relief is granted is that the parties will be back in Court in a few months time arguing about relief again in the context of different defaults. Indeed such a hearing is already scheduled to take place in April at which Paramount's alleged defaults in relation to the operation and maintenance of the Aircraft will be addressed.

118. This is not one of those cases where performance of the contract is essentially complete and all that is required is an identified further payment or payments. The ASLAs have four more years to run and I consider that there is a very real prejudice to Celestial in granting relief which obliges them to carry on in a long term contract with a contractual partner who they do not, with good reason, trust to perform and with whom they wish to sever relations, in accordance with the agreed contract terms.

119. As stated in the Goker case in which Lloyd LJ approved the following passage from the first instance judgment as follows (at p. 3):

‘Indeed, even if as at today the Plaintiff's past failures to make the payments due under his agreement could be compensated sufficiently as a condition of obtaining relief by the payment now of principal, interest and costs, that fails to take into account the full extent of any future risk—a risk which has been demonstrated already by the Plaintiff's unreliability and poor financial circumstances, and *199 which depends for security upon such a chattel as a car which, as contrasted with land, is easily moved, easily concealed and easily sold, is liable to rapid depreciation and may require considerable expenditure to maintain. Thus, as it was put by Sir Godfray, when a hirer has shown himself to be a defaulter, to oblige the owner of goods to forego his contractual rights and to return the goods to the hirer, would be to oblige the owner to accept a risk far greater than that contemplated when the contract was made.’

120. Many of those comments are at least as applicable here, and an aircraft is a chattel of much greater sophistication and value than a car, and one in respect of which continual maintenance of a high standard is required.

Conclusion on discretion

121. I have reached the clear conclusion that, notwithstanding the serious consequences which Paramount may suffer if the Aircraft are redelivered to Celestial, this is not an appropriate case for relief. In particular, the operative defaults were knowingly committed and there is no excuse or even explanation for them. They were committed against a background of persistent defaults evidencing a cavalier disregard by Paramount for its contractual obligations and despite clear warnings of the consequences of continuing default. The defaults have still not been cured and Paramount has been in further default as well as in breach of a Court Order. There is real prejudice to Celestial if relief is given and they are compelled to carry on with the ASLAs.

122. Even if the exercise of discretion was finely balanced, which it is not, it is well established that considerations of commercial certainty are relevant to the exercise of the Court's discretion and those considerations would lead me to the conclusion that relief should not be granted.

Conclusion

123. I refuse the equitable relief sought by Paramount on both jurisdictional and discretionary grounds. I shall hear the parties as to the terms of the relief to which Celestial is entitled in the light of that conclusion.

*(Order accordingly) *200*

Exhibit 6

***155 On Demand Information plc and another v Michael Gerson (Finance) plc and another**



Negative Judicial Consideration

Court

Court of Appeal (Civil Division)

Judgment Date

31 July 2000

Report Citation

[2001] 1 W.L.R. 155



Court of Appeal

Pill , Robert Walker LJJ and Sir Murray Stuart-Smith

2000 June 21, 22; July 31

Equity—Relief from forfeiture—Finance leasing agreement—Claimants leasing equipment from defendants—Claimants going into receivership and defendants terminating leases—Receiver obtaining order for sale of leased equipment and applying for relief from forfeiture—Jurisdiction to grant relief

Between September 1994 and May 1995 the claimant entered into four finance leases with the defendant of video and editing equipment. Each lease was for a primary period of 36 months during which the claimant paid a substantial rent, so that by the end of that period the defendant had recouped the cost of the equipment with interest, costs and profit. Thereafter the claimant could continue the lease for one or more periods of 12 months for a single modest payment on the first day of the period. The leases provided that the appointment of a receiver would constitute a repudiatory breach rendering the claimant liable to pay a termination sum. The claimant went into administrative receivership on 12 February 1998, and on 19 February the defendants gave notice terminating the leases. The primary period of two of the leases had expired, the third was within a few weeks of the expiry of its primary period and the fourth had about three months of the primary period still to run. The claimant's business had very little value save as a going concern. The receiver sold off part of the business, but the sole offer for the rest was conditional on the purchaser being able to take over the leased equipment. The receiver therefore sought, and on 5 March 1998 was granted, an order allowing the equipment to be sold free from any claim of the defendants provided the proceeds were held in escrow. After the sale the claimants issued a notice of motion seeking relief from forfeiture of the finance leases. The judge held that, although the court had jurisdiction to grant relief from forfeiture in the case of a finance lease while the leased asset remained unsold, there was no jurisdiction to grant relief after it had been sold.

On appeal by the claimants—

Held , dismissing the appeal, that a finance lease was in principle capable of attracting relief from forfeiture provided the object of the forfeiture provision in the lease was to secure the payment of money or to attain a specific and attainable result, namely security for the lessor's financial interest in the lease; that the fact that relief from forfeiture could not undo the appointment of the receiver was not decisive or even material provided that the terms on which relief was granted provided full protection for the lessor's financial interest; but that, although equity was willing to make adjustments in money, and had developed machinery for taking accounts to do so, the equitable jurisdiction was to relieve against the forfeiture of property

and not to rewrite bargains, especially commercial bargains; and that, accordingly (Sir Murray Stuart-Smith dissenting), since the object of relief from forfeiture was the continuation of the lease, not its extinction, the court could not grant relief in relation to a sum of money after the equipment had been sold (post, pp 174E–175E, H–176B , 179C–F , 181B–C , 183B–D).

Transag Haulage Ltd v Leyland DAF Finance plc [1994] 2 BCLC 88 approved .

Decision of George Laurence QC sitting as a deputy judge of the Chancery Division [1999] 2 All ER 811 affirmed .

The following cases are referred to in the judgments:

*BICC plc v Burndy Corpn [1985] Ch 232; [1985] 2 WLR 132; [1985] 1 All ER 417, CA *156*
Bank of Tokyo Ltd v Karoon (Note) [1987] AC 45; [1986] 3 WLR 414; [1986] 3 All ER 468, CA
Barrow v Isaacs & Son [1891] 1 QB 417, CA
Fuller v Judy Properties Ltd (1991) 64 P & CR 176, CA
Goker v NWS Bank plc (1990) [1999] GCCR 1507, CA
Helby v Matthews [1895] AC 471, HL(E)
Hill v Barclay (1811) 18 Ves 56
Inland Revenue Comrs v Duke of Westminster [1936] AC 1, HL(E)
Jobson v Johnson [1989] 1 WLR 1026; [1989] 1 All ER 621, CA
Lancashire Waggon Co Ltd v Nuttall (1878) 42 LT 465, CA
Larner v Fawcett [1950] 2 All ER 727, CA
McEntire v Crossley Bros Ltd [1895] AC 457, HL(I)
Mardorf Peach & Co Ltd v Attica Sea Carriers Corpn of Liberia (The Laconia) [1977] AC 850; [1977] 2 WLR 286; [1977] 1 All ER 545, HL(E)
Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade) [1983] QB 529; [1983] 2 WLR 248; [1983] 1 All ER 301, CA ; [1983] 2 AC 694; [1983] 3 WLR 203; [1983] 2 All ER 763, HL(E)
Securities and Investments Board v Pantell SA (No 2) [1993] Ch 256 ; [1991] 3 WLR 857; [1991] 4 All ER 883 ; [1993] Ch 256; [1992] 3 WLR 896; [1993] 1 All ER 134, CA
Shiloh Spinners Ltd v Harding [1973] AC 691; [1973] 2 WLR 28; [1973] 1 All ER 90, HL(E)
Sport Internationaal Bussum BV v Inter-Footwear Ltd [1984] 1 WLR 776 ; [1984] 1 All ER 376 ; [1984] 2 All ER 321, CA and HL(E)
Transag Haulage Ltd v Leyland DAF Finance plc [1994] 2 BCLC 88; [1994] BCC 356
Vaughan (Alf) & Co Ltd v Royscot Trust plc [1999] 1 All ER (Comm) 856
Whiteley Ltd v Hilt [1918] 2 KB 808, CA

The following additional cases were cited in argument:

Barton Thompson & Co Ltd v Stapling Machines Co [1966] Ch 499; [1966] 2 WLR 1429; [1966] 2 All ER 222
Belvoir Finance Co Ltd v Stapleton [1971] 1 QB 210; [1970] 3 WLR 530; [1970] 3 All ER 664, CA
Bristol Airport plc v Powdrill [1990] Ch 744; [1990] 2 WLR 1362; [1990] 2 All ER 493, CA
Hill v Bentco Leasing Inc (1986) 708 SW 2d 608
National Provincial Bank Ltd v Hastings Car Mart Ltd [1965] AC 1175; [1965] 3 WLR 1; [1965] 2 All ER 472, HL(E)
Shepherd v North West Securities Ltd 1991 SLT 499
Starside Properties Ltd v Mustapha [1974] 1 WLR 816; [1974] 2 All ER 567, CA
Stockloser v Johnson [1954] 1 QB 476; [1954] 2 WLR 439; [1954] 1 All ER 630, CA
Tulsa Port Warehouse Co Inc, In re (1982) 690 F 2d 809
Union Eagle Ltd v Golden Achievement Ltd [1997] AC 514; [1997] 2 WLR 341; [1997] 2 All ER 215, PC
Wickham Holdings Ltd v Brooke House Motors Ltd [1967] 1 WLR 295; [1967] 1 All ER 117, CA

APPEAL from George Laurence QC sitting as a deputy judge of the Chancery Division

By a notice of appeal dated 15 June 1999 the claimants, On Demand Information plc and On Demand Information International plc, appealed with the leave of Robert Walker LJ granted on 6 June 1999 from the order of George Laurence QC sitting as a deputy High Court judge on 5 March 1999 dismissing their action against the defendants, Michael Gerson (Finance) plc and Michael Gerson (Investments) Ltd, seeking relief from forfeiture of *157 certain equipment leases granted by the defendants. By the time the action had come on to be heard the equipment had been sold pursuant to an order made by Harman J on 5 March 1998.

The grounds of appeal were, inter alia, that the judge was wrong (1) to hold that (i) where equipment subject to finance leases had been sold pursuant to a court order as an interim measure to preserve the value of the equipment pending the hearing of an application for relief from forfeiture the court inexorably lacked jurisdiction to grant relief and (ii) in such cases relief from forfeiture would not make sense; (2) to construe the claimant's application for relief as an application to validate the sale by recourse to the equitable doctrine of relief from forfeiture, to refuse to grant relief on the basis that the sale could not be so validated and to hold that the equitable jurisdiction to relieve against forfeiture did not enable the court to rewrite to any extent the terms of the bargain between the parties; (3) to hold that the sale of the equipment deprived the court of jurisdiction to grant relief; (4) not to consider the claimant's alternative submissions that, as finance lessees, they had a proprietary interest in the equipment and the sale proceeds; (5) to hold that, even where there was a forfeiture of proprietary or possessory interest in property, the existence of jurisdiction to grant relief depended on a requirement that the primary object of the bargain was to secure a stated result which could still be effectively attained when the matter came before the court and the forfeiture provision had been added by way of security.

By a respondent's notice dated 7 July 1999 the defendants contended that the judge had been wrong to hold that but for the sale of the equipment the court had jurisdiction to grant relief from forfeiture. They contended that the court had no jurisdiction to grant relief from forfeiture in ordinary commercial cases unconnected with interests in land, and in the alternative that, if there was jurisdiction in relation to contracts other than those involving interests in land, it was confined to cases where there was a grant of a proprietary and not merely a possessory interest.

The facts are stated in the judgment of Robert Walker LJ.

Representation

Fidelis Oditah for the claimants.
Sir Roy Goode QC and Hugh Tomlinson for the defendants.

Cur adv vult
ROBERT WALKER LJ

31 July. The following judgments were handed down.

Introductory

This appeal is concerned with the court's jurisdiction to grant relief from forfeiture of a lease of tangible moveable property, and the circumstances in which that jurisdiction can or should be exercised. It is an appeal from an order made on 5 March 1999 by Mr George Laurence QC sitting as a deputy judge of the Chancery Division of the *High Court [1999] 2 All ER 811*. The deputy judge dismissed an action by the claimants, On Demand Information plc (“ODI”) and On Demand Information International plc (“ODII”), against the defendants, Michael Gerson (Finance) plc (“MGF”) and Michael Gerson (Investments) Ltd (“MGI”). ODII is a wholly-owned subsidiary of *158 ODI. Both companies are now in administrative receivership and for most purposes they can be referred to together as “On Demand”. Similarly MGF and MGI can for most purposes be referred to together as “Michael Gerson”.

The finance leases

The case is concerned with four finance leases of equipment (used for purposes such as making and editing videos) granted by Michael Gerson to On Demand. The deputy judge quoted a passage from a statement published by the Institute of Chartered Accountants, SSAP 21, which provides a convenient explanation of how a finance lease differs from an operating lease:

“ *Background* Leases and hire-purchase contracts are means by which companies obtain the right to use or purchase assets. In the UK there is normally no provision in a lease contract for legal title to the leased asset to pass to the lessee. A hire-purchase contract has similar features to a lease except that under a hire-purchase contract the hirer may acquire legal title by exercising an option to purchase the asset upon fulfilment of certain conditions (normally the payment of an agreed number of instalments). Current tax legislation provides that in the normal situation capital allowances can be claimed by the lessor under a lease contract but by the hirer under a hire-purchase contract.

“ *Forms of lease* Leases can appropriately be classified into finance leases and operating leases. The distinction between a finance lease and an operating lease will usually be evident from the terms of the contract between the lessor and the lessee. An operating lease involves the lessee paying a rental for the hire of an asset for a period of time which is normally substantially less than its useful economic life. The lessor retains most of the risks and rewards of ownership of an asset in the case of an operating lease. A finance lease usually involves payment by a lessee to a lessor of the full cost of the asset together with a return on the finance provided by the lessor. The lessee has substantially all the risks and rewards associated with the ownership of the asset, other than the legal title. In practice all leases transfer some of the risks and rewards of ownership to the lessee, and the distinction between a finance lease and an operating lease is essentially one of degree”

The deputy judge also referred to a passage in *Chitty on Contracts*, 27th ed (1994), vol 2, para 32–056 which has reappeared in substantially the same form in the latest edition, 28th ed (1999), vol 2, para 33–078.

The four finance leases were in the same terms, except for the details of the equipment and the financial terms. The form of lease is set out in an appendix to the deputy judge's judgment [1999] 2 All ER 811, 827–832. The terms can therefore be summarised fairly briefly. Each lease was for an initial period (the primary period) of 36 months. During the primary period the lessee paid a substantial rent which by the end of the primary period (as Mr Michael Gerson accepted in his affidavit evidence) recouped Michael Gerson for the cost of the equipment (which was specified in a schedule to the agreement) with interest, costs and profit. This rent was payable monthly but with an initial payment of three month's rent so that during the primary period rent was in effect being paid three months in advance. *159 Thereafter the lessee could continue the lease for one or more periods of 12 months (a secondary period) for a single modest payment made on the first day of the secondary period. The lease could be determined by not less than 60 day's notice to expire on the last day of the primary period or any secondary period.

Schedule 2 to the agreement contained a variety of conditions, of which the most important for present purposes were in paragraph 9 (headed “default”) and paragraph 12 (headed “sales agency appointment”). Paragraph 9(A) provided that, on a repudiatory breach by the lessee, Michael Gerson might accept the breach as a repudiation of the agreement and, at its option, all or any other lease agreements between the same parties. By paragraph 9(B)(iv) the appointment of a receiver of the lessee's undertaking or assets constituted a repudiatory breach. Paragraph 9(C) provided that on acceptance of a repudiatory breach the lessee should pay an amount (the termination sum) including any arrears of rent, any rent to become due during any unexpired part of the primary period, and compounded interest on arrears, but with a possible credit (the terms of which are obscure, and can be ignored for present purposes).

Paragraph 12(A) was in the following terms (with one obvious error corrected):

“Sales agency appointment (A) Subject to the lessee having duly performed its obligations under this agreement and any other lease agreement upon termination of the leasing of the equipment at the end of the primary period or at any time thereafter by notice from the lessee in accordance with the provisions of this agreement, the lessee is appointed the sales agent of the owner to negotiate a sale of the equipment to a third party (not being a parent, subsidiary or

associated company of the lessee) at the best price available, such price to be [communicated] to and approved by the owner prior to the sale”

Sub-paragraphs (B) and (C) dealt with the terms of sale, and provided that the agency appointment should continue for six months after the termination or expiry of the lease. Sub-paragraphs (D) and (E) were in the following terms:

“(D) In the event of any breach by the lessee of the terms of this appointment or of this agreement (including without limitation the occurrence of any of the events specified in paragraph 9 above) or any other lease agreement then the authority of the lessee to act as agent in relation to any equipment shall cease forthwith. (E) In the event that the lessee is successful in negotiating a sale of the equipment the owner agrees to allow the lessee by way of rebate of rental a sum equal to 95% of the sale proceeds in respect of the equipment after deducting any value added tax thereon and any reasonable expenses incurred by the lessee in negotiating the sale.”

The general effect of the conditions (especially paragraphs 2, 4 and 6 was to allocate all risks and responsibilities in respect of the equipment (including its selection, use, maintenance and insurance) to the lessee. The four leases were entered into on dates between September 1994 and May 1995, so that the four primary periods were to expire between *160 September 1997 and May 1998. The equipment comprised in the leases was all installed at On Demand's premises at 2 Burley Road, Leeds.

On Demand goes into receivership

On 12 February 1998 On Demand went into administrative receivership under debentures in favour of Lloyds Bank entered into on 16 October 1995. On 19 February 1998 Michael Gerson gave notice to On Demand terminating all four lease agreements on the ground that receivers had been appointed. The position under the four leases at that date was summarised by the deputy judge as follows. (1) The first and second leases (dated 5 September 1994 and 20 October 1994 respectively) had continued beyond the primary period and were in the first secondary period. Michael Gerson had received primary rentals totalling about £295,000 (plus VAT) and secondary rentals totalling about £2,500 (plus VAT) in respect of equipment which had cost about £242,000 (plus VAT). (2) The third lease (dated 31 March 1995) was very close to the end of its primary period and all the primary rentals had been paid (about £377,000 plus VAT in respect of equipment which had cost about £310,000 plus VAT). It was not clear whether the secondary rent had been paid in advance. (3) The fourth lease dated 17 May 1995 had about three months of its primary period still to run. On Demand had paid primary rentals totalling about £120,000 (plus VAT) in respect of equipment which had cost about £100,000 (plus VAT) but about £3,000 (plus VAT) for future primary rental became due under paragraph 9(C) of the conditions.

On Demand's business was organised in two divisions, called Creative Convergence (which used the leased equipment) and New Media Publishing. The receivers sold New Media Publishing very quickly, the sale being made on 20 February 1998. The other division, Creative Convergence, had 78 employees. The receivers were faced with the dilemma that its business was (as Mr Edward Klempka, one of the receivers, deposed) “heavily reliant on its people, their contacts and their expertise”, so that it had very little value except as a going concern; but the continuing liability for salaries and wages was very heavy. In his affidavit sworn on 4 March 1998 Mr Klempka stated: “as the position presently stands, unless a sale can be concluded within the next 24 hours and at the very latest by Friday this week”—6 March 1998—“it is highly likely that the business will have to close”

The receivers had only one serious offer for the business of Creative Convergence. That offer was not only approved by the employees but involved the participation of a number of senior employees. It would be feasible only if the proposed purchaser could take over the premises and the leased equipment which was installed there. In these circumstances the receivers decided to make an application to the Chancery Division. The application was prepared at very short notice. Michael Gerson and its lawyers were informed of the application but had even less time to consider it. Decisions were taken in haste, possibly without sufficient time for all their implications to be considered.

On 2 March 1998 the receiver's solicitors, Walker Morris, wrote to Michael Gerson referring to the termination of the leases and pointing out that but for the appointment of receivers: **161*

“the economic benefit which [MGF] could expect to derive from the lease agreements would amount to the unpaid [primary rent under the fourth lease], together with 5% of the net sale proceeds upon a sale being negotiated by [On Demand].”

The letter stated that the equipment had a material value, possibly exceeding £130,000. It referred to *Transag Haulage Ltd v Leyland DAF Finance plc [1994] 2 BCLC 88* and to paragraph 12(A) and (E) of the conditions. It indicated that the receivers were considering an urgent application to the court. A second letter on the same day recorded that Michael Gerson's valuers had inspected the equipment and valued it, on a going-concern basis, at about £300,000. The letter made an open offer of £30,000 out of the sale proceeds, in full and final settlement, if Michael Gerson would agree to an immediate sale. However a third letter, also on the same day, indicated that the parties had been unable to reach agreement.

That was the background to a letter from Mr Gerson to Mr Klempka which was written on 2 March but not received by fax until just after 8 am on 3 March. Apart from a paragraph referring to some missing items of equipment, Mr Gerson's letter was:

“I confirm our conversation of this morning when I put forward the suggestion that without prejudice to the terms and conditions of our four leases and the rights existing under those leases, that in order to enable the best realisable price to be negotiated, in the interest of saving jobs at the company, and to preserve any goodwill, you should negotiate a sale to any interested party with which we will co-operate as owner (but without our conferring any warranty as to condition or use of the goods) subject to agreement on price with our valuer and that the proceeds of sale should be paid into an escrow account giving you the option to apply to the court in accordance with the principles set out in the *Transag Haulage* case to which you referred, within a period of 60 days and with you bearing all the costs of the action in order to obtain clarification of the law. As I advised you, our own legal advice is that the circumstances are not comparable in any way and particularly because under the terms of our finance lease agreement, at no time whatsoever would a lessee obtain rights of ownership or have a proprietary interest capable of being protected by a claim for relief from forfeiture. We have spoken subsequently and the figures to which you refer fall so far short of the expert valuation which we have, that I see no alternative but for us to endeavour to dispose of the goods as best we can. I am however willing to hear from you with any further proposal you have to make... I reserve our company's rights generally under the leases. I have instructed Royds Treadwell to accept service of any writ”

The judge did not refer to this correspondence in his judgment, probably because it did not at the hearing before him receive as much attention as it has in this court, where Dr Fidelis Oditah (for On Demand) has gone through it in detail.

The hearing before Harman J

The outcome was that On Demand issued a writ on 4 March 1998 claiming relief from forfeiture (and other relief) and issued two notices of **162* motion, one ex parte and the other on notice. The former sought an order for sale of the equipment free from any claim of Michael Gerson on terms that the net proceeds were to be held in an escrow account. The latter sought relief from forfeiture of the finance leases, and other relief. In the event the ex parte motion was heard by Harman J on notice on 5 March 1998 and was for practical purposes disposed of by consent, although the order was not formally a consent order. The other motion was heard by Mr Laurence QC and was by consent treated as the trial of the action. This was possible only because On Demand conceded a number of factual issues which could not have been resolved without oral evidence: see *[1999] 2 All ER 811*, 818.

In an affidavit sworn on 5 March 1998 Mr Gerson deposed:

“[Michael Gerson] do not accept that [On Demand] have any right to ‘relief from forfeiture’ of the leases. However, solely for the purpose of [On Demand's] application for interlocutory relief being made on 5 March 1998, [Michael Gerson] will accept that there is an arguable case on this point. I understand that the receivers wish to sell [On Demand's] business as a matter of extreme urgency and that they believe that the equipment is a vital part of that sale. In these circumstances, [Michael Gerson] are prepared to consent to an order for the sale of the equipment and will agree that good title shall pass to the purchaser. In order to hold the position pending a full hearing of the motion, the proceeds of sale should be paid into an escrow account as contemplated by the notice of motion. However, [Michael Gerson] wish to reserve their rights in relation to such sales. In my respectful submission, it should be clear on the face of the order that it is made without prejudice to [Michael Gerson's] contention that it is entitled to the full value of the goods at the date of sale.”

He went on to make clear that Michael Gerson did not accept that the part of the total sale proceeds apportioned by the receivers to the equipment (£131,500 if some upgraded equipment was excluded) would necessarily reflect the true sale value of the equipment. That was one of the points which On Demand later conceded.

That was the background to Harman J's order of 5 March 1998, the substantive part of which was:

“The plaintiffs and each of them be at liberty to sell or otherwise dispose of the equipment the subject of the finance lease agreements specified in the schedule hereto and give a good and valid title to the purchaser or disponee free from any claim by the defendants or either of them upon the terms that the net proceeds of the said sale or disposition be held in an escrow account pending the hearing of the inter partes motion on notice in this action, provided that the defendants shall be at liberty hereafter to contend that the break-up value of the said equipment was more than £130,500.”

As already noted, much more attention was directed to these events on the hearing of the appeal than had been directed to them before the deputy judge. Indeed in this court Dr Oditah began to formulate a very late amendment so as to plead that these events amounted to an estoppel preventing Michael Gerson from contending that the sale prejudiced On Demand's claim to relief from forfeiture, if such a claim existed before the *163 sale. Dr Oditah rightly did not press his application for an amendment. It had no solid foundation in any findings of fact made by the deputy judge. On Demand's advisers seem to have thought (or hoped) that an immediate sale would not prejudice their claim for relief, and to have taken this view as a matter of law (rather than because of any agreement or estoppel). Michael Gerson's advisers seem to have formed no view on the point, while aware (as was accepted by Mr Tomlinson, who appeared for Michael Gerson before Harman J) that Harman J's order was not the end of the matter, and that the claim for relief from forfeiture was going to be pursued. That is reflected in the deputy judge's summary of the position before him [1999] 2 All ER 811 , 817:

“it was common ground before me that Harman J's order did not prevent the defendants from contending that there was no jurisdiction in the court to grant relief from forfeiture of the leases of the equipment or from contending, when the plaintiff's motion came on substantively, that if there was such jurisdiction it ought not to be exercised in this case.”

The deputy judge therefore proceeded to consider the general question of the court's jurisdiction to grant relief from forfeiture in the case of a lease of this sort, where the equipment remained unsold. He then went on to consider the effect of the sale. On the general issue he concluded that the court had jurisdiction to grant relief from forfeiture, but on the narrower issue he concluded that just as he had no jurisdiction to rewrite the finance leases so as to remould condition 12, so

“there can be no jurisdiction, in the events which have happened, to make an order granting relief which would have precisely the same effect. [On Demand] took their chance when asking the court in March 1998 to sanction a sale, that it would later turn out to be impossible to persuade the court to validate such a sale by recourse to the equitable doctrine of relief from forfeiture”: see p 826.

In this court Dr Oditah has challenged the narrower conclusion and Sir Roy Goode (appearing with Mr Tomlinson for Michael Gerson) has by a respondent's notice challenged the wider conclusion. Both raise issues of some general interest and some difficulty.

Relief from forfeiture

The principles of the modern law as to non-statutory relief from forfeiture (that is, relief under the court's inherent equitable jurisdiction) are to be found principally in three decisions of the *House of Lords made between 1972 and 1984, that is Shiloh Spinners Ltd v Harding [1973] AC 691*, *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade) [1983] 2 AC 694* and *Sport Internationaal Bussum BV v Inter-Footwear Ltd [1984] 1 WLR 776*, and in the decision of this court in *BICC plc v Burndy Corpn [1985] Ch 232*. Those and other authorities were closely examined in the course of argument. But before embarking on these authorities it will be useful to identify briefly some basic themes to which counsel drew attention in their reviews of the authorities and in the submissions which they based on them. These are the commercial nature of the finance leases; the fact that the subject matter of the leases was not a permanent asset (land) but chattels which were depreciating rapidly and *164 whose useful life was expected to be short; and the nature of the economic interests under the leases of the lessor and the lessee respectively, including the likely effect of the agency created by condition 12.

Dr Oditah urged that the lessor's real interest in the equipment was a purely financial interest. Its "reversion" to the equipment on termination of the leases was unlikely to be of any value and might simply be a nuisance, as was demonstrated by the low level of the secondary rents and the terms of condition 12. Possession and control of the equipment, and all the risks which attended it, were the lessee's from the inception of the transaction. The lessor was owner of the equipment only because that was essential to its claim to capital allowances for tax purposes. Because the lessor's interest was purely financial, the leases were in the nature of a security. The deputy judge took too narrow a view of the remedial flexibility of the jurisdiction, and in granting relief it was not necessary for the court to reconstitute precisely the lessor-lessee relationship.

Sir Roy Goode addressed the same points, but with very different aims in view. He relied on the commercial character of the finance leases and on the importance of certainty in commercial transactions. He submitted that although the finance leases were referred to as leases, the rights (in respect of chattels, not land) which they conferred on On Demand were purely contractual, and so outside the scope of relief for forfeiture, which is concerned with proprietary rights. Moreover chattels of this type are precarious and wasting assets and the court should not interfere with the terms of a commercial bargain for their hire. As to Dr Oditah's submissions about the parties' economic interests and the substance of the transaction, Sir Roy referred to the decisions of the *House of Lords in McEntire v Crossley Bros Ltd [1895] AC 457* and *Helby v Matthews [1895] AC 471* (he might also have referred to *Inland Revenue Comrs v Duke of Westminster [1936] AC 1*, 20, where Lord Tomlin cited *Helby v Matthews*). Finally Sir Roy submitted that what Dr Oditah termed remedial flexibility would amount to an impermissible rewriting of the parties' contracts.

With those themes and submissions in mind I turn to the authorities. *Shiloh Spinners Ltd v Harding [1973] AC 691* is of outstanding importance for Lord Wilberforce's survey of the development of the law and his statement of the principles to be derived from it (on which the House of Lords had heard from eminent leading counsel submissions which occupy over 20 pages of the report). The case was unusual in that, although it concerned a leasehold interest, it did not concern relief from forfeiture by exercise of a landlord's right of re-entry. The right of re-entry had been reserved on the assignment (and not on the initial grant) of a term of years in order to reinforce covenants (to support, fence and repair) which were taken for the benefit of other retained land of the assignor. That gave rise to conveyancing issues not connected with relief from forfeiture. It also meant that relief from forfeiture had to be considered in relation to the inherent equitable jurisdiction, without modifications and extensions effected by statutes applying as between landlord and tenant.

Lord Wilberforce made a broad statement of principle, at p 722:

“There cannot be any doubt that from the earliest times courts of equity have asserted the right to relieve against the forfeiture of property. The jurisdiction has not been confined to any particular type of case. The *165 commonest instances concerned mortgages, giving rise to the equity of redemption, and leases, which commonly contained re-entry clauses; but other instances are found in relation to copyholds, or where the forfeiture was in the nature of a penalty. Although the principle is well established, there has undoubtedly been some fluctuation of authority as to the self-limitation to be imposed or accepted on this power”

He then identified two well-recognised heads of the jurisdiction. The first is “where it is possible to state that the object of the transaction and of the insertion of the right to forfeit is essentially to secure the payment of money”. The second is a case of fraud, accident, mistake or surprise. Lord Wilberforce continued:

“Outside of these there remained a debatable area in which were included obligations in leases such as to repair and analogous obligations concerning the condition of property, and covenants to insure or not to assign.”

Covenants of that sort cannot be viewed as being essentially a security for the payment of money, because they are concerned with the condition of the leased property and its value to the landlord when his reversion falls into possession. (That is why Dr Odiah has made a virtue of the impermanence of the subject matter of the finance leases, arguing that the lessor's reversion is illusory and its only substantial interest is financial.)

After discussing a number of old authorities (including the well known judgment of Lord Eldon LC in *Hill v Barclay (1811) 18 Ves 56* and also *Barrow v Isaacs & Son [1891] 1 QB 417*, which he described as “a high-water mark of the strict doctrine” Lord Wilberforce said [1973] AC 691, 723:

“it remains true today that equity expects men to carry out their bargains and will not let them buy their way out by uncovenanted payment. But it is consistent with these principles that we should reaffirm the right of courts of equity in appropriate and limited cases to relieve against forfeiture for breach of covenant or condition where the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the court, and where the forfeiture provision is added by way of security for the production of that result.”

So to find that a forfeiture provision is security for the production of “a stated result which can effectively be attained” on the hearing of an application for relief is a third head under which the jurisdiction may be exercised. The rest of the House of Lords agreed with Lord Wilberforce, Lord Simon of Glaisdale, at pp 726–727, showing some inclination towards a more liberal view of the jurisdiction (as he was to do in *Mardorf Peach & Co Ltd v Attica Sea Carriers Corp'n of Liberia (The Laconia) [1977] AC 850*, 873–874).

In *The Scaptrade [1983] 2 AC 694 the House of Lords* unanimously rejected the proposition that relief from forfeiture was available when a shipowner exercised a contractual right to withdraw a vessel hired under a time charterparty. It was critically important to the decision that the hiring was by time charter and was not a demise charter or a lease (see the argument of the shipowner's counsel, at the invitation of their Lordships, *166 at p 698, and the speech of Lord Diplock at pp 700–702 and again at p 704). Lord Diplock quoted Lord Wilberforce's general statement of principle in the *Shiloh Spinners case [1973] AC 691* and said that it was clear

“That this mainly historical statement was never meant to apply generally to contracts not involving any transfer of proprietary or possessory rights, but providing for a right to determine the contract in default of punctual payment of a sum of money payable under it”: see [1983] 2 AC 694, 702.

This reflected Lord Diplock's earlier observation, at p 700, that a time charter confers on the charterer no interest in or right of possession of the vessel, but is a contract for services to be rendered to the charterer by the shipowner through the shipowner's employees (that is the master and crew). Lord Diplock also quoted with approval a fairly lengthy passage from the judgment of Robert Goff LJ [1983] QB 529 , 540–541 in this court as to the importance of certainty to the parties to a commercial contract.

The third decision of the *House of Lords, Sport Internationaal Bussum BV v Inter-Footwear Ltd* [1984] 1 WLR 776 , was concerned with a contractual licence to use names and trademarks for sports shoes. An earlier action between the parties had been stayed on the terms scheduled to a Tomlin order, which provided for Inter-Footwear to pay £105,000 in three instalments and to have a licence (partly exclusive and partly non-exclusive) to use the names and marks. If any instalment was not paid on the due date, the whole unpaid balance became due at once and the licensor could determine the licence. There was a delay in payment of the second instalment and the licensor terminated the licence. Staughton J, this court and the House of Lords all held that the court had no jurisdiction to grant relief from forfeiture.

Oliver LJ, delivering the judgment of this court, said, at p 786, that taken at its narrowest *The Scaptrade* [1983] 2 AC 694 :

“may be said to establish no more than this: that the equitable jurisdiction to relieve against forfeiture does not extend to a time charter not being a charter by demise. There is, however, the more general proposition to be derived from it, that, even where the primary object of the insertion of a forfeiture clause may be said to be to secure the payment of money or the performance of some other obligation, the equitable jurisdiction does not extend to contracts which do not involve the transfer or creation of proprietary or possessory rights.”

Oliver LJ referred to the need for certainty in commercial contracts and expressed doubt as to whether the licensor's right to terminate the licence in the event of default could be regarded as being primarily a security for the payment of money. Oliver LJ went on, at p 789:

“This is sufficient to dispose of the appeal but, in fact, there appears to us to be another reason why the equitable jurisdiction to grant relief could not apply to a case such as this. The case is one of contract only and, in so far as there were any rights created or transferred which could be described as ‘proprietary’, they were rights which rested only in contract and to that extent distinguishable from the legal estate created by the grant of a lease or a mortgage. Assuming that relief were capable of being *167 granted, effectively it could be granted only by compelling the plaintiffs to regrant the permission which had been revoked. An exclusive licence to use a trade mark creates no estate, although it enables the licensee to obtain an injunction if the licensor, in breach of contract, seeks to use the mark in competition with him. Thus, effectively, the licensee applying for relief from forfeiture is in exactly the same position as the charterer in [*The Scaptrade*]”

In the House of Lords the leading speech was given by Lord Templeman. After referring to what Lord Diplock said in *The Scaptrade* about proprietary or possessory rights Lord Templeman continued, at p 794:

“Mr Wilson submitted that in the present case the licences to use the trade marks and names created proprietary and possessory rights in intellectual property. He admits, however, that so to hold would be to extend the boundaries of the authorities dealing with relief against forfeiture. I do not believe that the present is a suitable case in which to define the boundaries of the equitable doctrine of relief against forfeiture. It is sufficient that the appellants cannot bring themselves within the recognised boundaries and cannot establish an arguable case for the intervention of equity. The recognised boundaries do not include mere contractual licences and I can see no reason for the intervention of equity.”

A few days after the decision of the *House of Lords in the Sport Internationaal* case this court heard an appeal in *BICC plc v Burndy Corpn* [1985] Ch 232 . BICC and Burndy had been co-owners of a joint venture company, BICC-Burndy, to exploit

know-how and other intellectual property rights. In 1979 they entered into a complex series of agreements intended to wind up the joint venture and disentangle their commercial association. There was a particular problem about new patent rights which were vested in BICC-Burndy. There was no obvious way of unscrambling these rights and so (as Dillon LJ explained, at pp 241–242) the part of the contractual arrangements referred to as the assignment provided for the continued exploitation of what were called the joint rights, with a provision (in clause 10(iii) of the assignment) for either party (if in default as to its financial obligations) to be required to assign the relevant rights to the other party. It is not necessary to go further into the rather complicated facts; the case is important for what Dillon LJ (with the concurrence of Kerr and Ackner LJJ) said about relief from forfeiture. Falconer J had held that he had no jurisdiction to grant relief from forfeiture because clause 10(iii) was part of a commercial arrangement between parties bargaining at arm's length. Dillon LJ said, at pp 251–252:

“The judge decided, in reliance especially on the judgment of the *Court of Appeal in Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] QB 529, that the court had no such jurisdiction, because the assignment was a commercial agreement between commercial parties. The decision of the *Court of Appeal in The Scaptrade* was, as the judge noted, affirmed by the *House of Lords* [1983] 2 AC 694. As I understand the decision of the House of Lords, however, and the decision of the *House of Lords in the subsequent case of Sport Internationaal Bussum BV v Inter-Footwear Ltd* [1984] 1 WLR 776, *168 their effect was to confine the court's jurisdiction to grant relief against forfeiture to contracts concerning the transfer of proprietary or possessory rights: see the speech of Lord Templeman in the latter case at p 794. The present case, however, is distinguishable from those cases in that clause 10(iii) of the assignment is concerned with a transfer of property rights. In *Shiloh Spinners Ltd v Harding* [1973] AC 691, the *House of Lords* held that the court had jurisdiction to grant relief against forfeiture of proprietary rights in circumstances outside the ordinary landlord and tenant relationship; but the case was concerned with a claim for relief against a right of re-entry on land, and the speeches do not cast light on the extent to which jurisdiction exists to grant relief against forfeiture of property other than an interest in land. In *Barton Thompson & Co Ltd v Stapling Machines Co* [1966] Ch 499, 509, Pennycuik J considered it to be arguable that relief could be granted against forfeiture of a lease of chattels. That view seems to have been approved by Edmund Davies LJ in *Starside Properties Ltd v Mustapha* [1974] 1 WLR 816, 822; and in *Stockloser v Johnson* [1954] 1 QB 476, 502, Romer LJ apparently considered that the court would have power in an appropriate case to grant relief by way of extension of time to a purchaser of a diamond necklace who had failed to pay the final instalment of the price in due time. There is no clear authority, but for my part I find it difficult to see why the jurisdiction of equity to grant relief against forfeiture should only be available where what is liable to forfeiture is an interest in land and not an interest in personal property. Relief is only available where what is in question is forfeiture of proprietary or possessory rights, but I see no reason in principle for drawing a distinction as to the type of property in which the rights subsist. The fact that the right to forfeiture arises under a commercial agreement is highly relevant to the question whether relief against forfeiture should be granted, but I do not see that it can preclude the existence of the jurisdiction to grant relief, if forfeiture of proprietary or possessory rights, as opposed to merely contractual rights, is in question. I hold, therefore, that the court has jurisdiction to grant Burndy relief”

Moreover the court would if necessary have exercised its discretion to grant relief (differing from Falconer J on that point also). It was not necessary because Burndy succeeded on another point as to equitable set-off.

In *Jobson v Johnson* [1989] 1 WLR 1026 this court was concerned primarily with the issue of whether an unusual provision in a contract for the sale of shares in a private company, the purchase price being payable by instalments, amounted to a penalty clause. Nicholls LJ, at p 1043, observed, and Kerr LJ, at p 1047, agreed, that the provision in question was something of a hybrid, in that, although having the essential characteristics of a penalty clause, it also resembled a forfeiture clause. That influenced the relief which this court decided to furnish, after considering various alternatives to meet the unusual circumstances of the case: see Dillon LJ, at pp 1037–1038, Nicholls LJ, at pp 1045–1046, and Kerr LJ, who took a different view on this point, at pp 1048–1050.

The next case to be decided (although only recently reported) is *Goker v NWS Bank plc* (1990) [1999] GCCR 1507. The claimant had entered into a deferred purchase agreement to buy a Mercedes convertible for a total of *169 £45,690 payable over three years. He repeatedly defaulted in his obligations but, when the car was repossessed, he claimed relief from forfeiture. Eminent counsel for the defendant conceded that there was jurisdiction to grant relief, but it was refused as a matter

of discretion. The case is of interest mainly for the observations of Lloyd and Nicholls LJ as to the different considerations which apply depending on whether the subject matter is land or chattels. Lloyd LJ said, at p 1510:

“In the case of land the underlying security remains intact and is not impaired; in the case of a chattel the underlying security is likely to be much more vulnerable. Thus, in the case of a car, it may be sold; it may be taken abroad; it may be damaged as the result of a road accident, or it may be stolen. Furthermore, it requires continuing expenditure on insurance and on maintenance and above all it will continue to depreciate. None of those factors applies to land, or if they do apply only to a limited extent. If authority is needed for the proposition that different results may flow in different types of case, it is to be found in the judgment of Dillon LJ in the case of *BICC plc v Burndy Corpn* [1985] Ch 232 , 252, where he said: ‘The fact that the right to forfeiture arises under a commercial agreement is highly relevant to the question whether relief against forfeiture should be granted.’”

Nicholls LJ made similar observations, at p 1512.

The next case is *Transag Haulage Ltd v Leyland DAF Finance plc* [1994] 2 BCLC 88 , a decision of Knox J. Indeed the deputy judge started his discussion of the law with Knox J's citation of a passage from *Snell's Equity* , 29th ed (1990), para 1, pp 541–542; the corresponding passage in the 30th ed (2000), para 36–14, p 599 is in identical terms except for some additions to the footnotes.

Sir Roy has submitted that the *Transag* case was wrongly decided and should be overruled. It was concerned with hire-purchase agreements for the hire of three lorries entered into by Transag, a haulier, between January and May 1991. The total purchase price for the three lorries was £177,333, with down payments totalling £69,333 and the balance (for each vehicle) due by 36 monthly payments of £1,000. Transag went into administrative receivership in November 1993, when only about £14,000 remained to be paid and the lorries were worth about £67,000. The agreements were in standard form and contained provision (clause 13) for termination by the owner after an event of default, which included receivership; provisions (clause 14) spelling out the consequence of termination, including return of the vehicles to the owner and an immediate liability for outstanding instalments; and (clause 24):

“If the hirer (having duly observed and performed all the terms and conditions of this agreement whether expressed or implied, and having paid all sums due under this agreement) shall pay to the owner the sum of £5 the hiring thereby constituted shall determine and the hirer shall become the absolute owner of the goods but until such time the goods shall remain the sole property of the owner and the hirer shall be a mere bailee thereof.”

Transag sought a declaration that the relevant provision of clause 13 was a penalty (a claim which failed) and alternatively relief from forfeiture. *170 Knox J held that he had jurisdiction to grant relief, and that the case was “one of those rare cases” where it would be right for the court to exercise its discretion and grant relief on terms that the outstanding instalments were to be paid within seven days. It does not appear from the report (or from another report [1994] BCC 356) whether the order accelerated (or otherwise referred to) the clause 24 option.

Sir Roy's attack on the *Transag* case was directed mainly to Knox J's observation [1994] 2 BCLC 88 , 99 that Transag's contingent right to exercise its option under clause 24 (and buy each lorry for £5) could properly be described as a proprietary right. Sir Roy submitted that it was a purely contractual right, and referred on that point to the decision of this court in *Whiteley Ltd v Hilt* [1918] 2 KB 808 (and especially to what Warrington LJ said at pp 819–820). Sir Roy went on from there to point out that On Demand's rights under the agency provision in condition 12 were even less proprietary in character, being simply a right to 95% of the net proceeds after an approved sale (which necessarily vested ownership of the equipment in a third party).

I have to say that I do have difficulty with the part of Knox J's judgment to which criticism is directed. But my difficulty is not so much with Knox J's conclusion as with the narrow terms in which he seems to have seen the issue when he said, *[1994] 2 BCLC 88*, 99, immediately after his citation of *Snell* :

“The only forfeiture that I can discern in the case before me where no claim is being made in respect of past payments by the company is the loss of the contingent right to buy the goods for £5 under clause 24.”

I find this puzzling because Knox J had already referred in detail, at pp 92–93, to the receiver's evidence that continued possession and use of the three lorries was essential to the conduct of Transag's business, which the receivers hoped to sell as a going concern. I think that Knox J could have based his decision on Transag's possessory rights during the currency of each of the hire-purchase agreements, as well as on its option to purchase under clause 24 once the agreement had run its course.

Those possessory rights arose under contracts but I cannot accept the submission that those rights, or the rights of On Demand under the finance leases, were purely contractual rights if that intensive implies that they had insufficient possessory character to meet the principles which emerge from the authorities considered above.

What was said in *Whiteley Ltd v Hilt* seems to me to be well in line with those principles. Whiteleys and Miss Nolan entered into a hire-purchase agreement for the hire of a piano, which Miss Nolan purported to sell to the defendant. Whiteleys sued the defendant for detinue or conversion, and the real issue was as to the measure of damages. Warrington LJ said *[1918] 2 KB 308*, 819–820:

“The nature of the interest taken by the hirer under the agreement appears to me to be this: First, a right to retain possession of the chattel so long as she performed the conditions of the agreement. Secondly, an option to purchase the chattel exercisable by payment of the instalments provided for by the contract.”—The third right was a right of reinstatement after default under a special provision of the contract— *171 “That, in my opinion, was the interest of the hirer. The general property in the chattel no doubt remained in the plaintiffs, but that general property in it was qualified and limited by the contractual interest conferred by the agreement upon the hirer. Now, was that interest assignable? In my opinion it clearly was”

Contractual rights which entitle the hirer to indefinite possession of chattels so long as the hire payments are duly made, and which qualify and limit the owner's general property in the chattels, cannot aptly be described as purely contractual rights.

For these reasons I consider that the *Transag case [1994] 2 BCLC 88* was correctly decided (although I respectfully think that Knox J might have based his decision on broader grounds) and that a finance lease is in principle capable of attracting relief from forfeiture provided that the provision occasioning forfeiture satisfies one or other of the two relevant conditions stated by Lord Wilberforce in the *Shiloh Spinners case [1973] AC 691* (security for payment of money, or security for attaining a specific and attainable result). The fact that a finance lease is a commercial contract of a very familiar sort and the fact that its subject matter is chattels (not land) may be very material to the question whether relief should be granted (as this court recognised in *BICC plc v Burndy Corpn [1985] Ch 232* and *Goker v NWS Bank plc [1999] GCCR 1507*, and as Knox J recognised in the *Transag case*) but that goes to the exercise of discretion, not to jurisdiction. (It may also be noted, as Millett LJ has pointed out in his lecture “Equity's Place in the Law of Commerce” (1998) *114 LQR 214*, that land is also a subject of commerce and leases of land and buildings are commercial transactions.) Moreover the impermanence of chattels such as video equipment and motor vehicles (as compared with land and buildings) does not to my mind go all one way. I recognise the points made in *Goker v NWS Bank plc*, but the absence (in most likely circumstances) of any “reversion” of significant value, after the termination of On Demand's finance leases, gives force to Dr Oditah's submission that Michael Gerson's real interest in the finance leases was a financial interest. To say that is not to disregard legal rights and obligations in favour of economic substance (as to which see Robert Goff LJ in *Bank of Tokyo Ltd v Karoon (Note) [1987] AC 45*,

64). It is a legitimate consideration if On Demand is to satisfy one or other of the conditions stated by Lord Wilberforce in the *Shiloh Spinners* case.

For these reasons I consider that the deputy judge was right in his first general conclusion on jurisdiction [1999] 2 All ER 811 , 822. Indeed, but for Sir Roy's spirited attack on the *Transag* case (which the deputy judge took as his point of departure) I would have dealt with the point much more shortly by saying that I agree with the deputy judge for the reasons which he gave.

I consider that he was also right in his conclusion that the “security” requirements were satisfied. I can give my reasons quite shortly, since most of the ground has been covered already. It is not to disregard the legal substance of the finance leases to accept (as I do) the submission that Michael Gerson's real interest in the leases was a financial one. The terms of the leases demonstrate that and it is confirmed by Michael Gerson's reaction to the receivership, which was that the equipment should be sold (there may have been in this some element of altruism and wanting to save jobs, but at *172 the lowest it cannot be said that Michael Gerson was pressing to have the equipment removed from the Burley Road premises in order to put it on the market). Mr Gerson's second affidavit did not cast doubt on this conclusion, for the reasons stated by the deputy judge, at p 824.

Sir Roy has submitted that the deputy judge went wrong on this point because he confused the “stated result” (in Lord Wilberforce's phrase in the *Shiloh Spinners case* [1973] AC 691 , 723) with the purpose of the whole transaction, and so emptied the requirement of all content. That submission calls for serious consideration, but I cannot accept it. I can see its force in a lease of land and buildings, where the landlord is interested not only in the rent but also in the condition and use of the premises both during the term and on the reversion falling into possession. But, if the lessor's only real interest is in securing the prompt and regular payment of rentals under a finance lease, any provision for forfeiture on any act of default (including the appointment of receivers) can readily be seen as a security to attain that end. The fact that relief against forfeiture cannot undo the appointment of the receivers is not decisive or even material provided that the terms on which relief is granted provide full protection for the lessor's financial interest. If the lessee is insolvent, it will generally be impossible to provide full protection for the lessor, and so relief will not be granted. But the facts of this case, and those of the *Transag case* [1994] 2 BCLC 88 , show that the amount of the outstanding instalments due to the lessee when receivers are appointed may be quite modest, and the windfall to the lessor (if relief is not granted) correspondingly large. My feeling that equity should be able to give relief in such circumstances does not depend on Dr Oditah's wider submissions (on which I express no view) as to the need to promote a “rescue culture” in insolvency law.

The effect of the sale

Here at last I come to the subject matter of On Demand's notice of appeal (as opposed to Michael Gerson's respondent's notice). The court's conclusion (in relation to a finance lease of the type now under consideration) that relief from forfeiture can in principle be granted leads on to the question, what form can that relief take? In particular, can the court in any way accelerate the time, or modify the conditions, at or on which the lessee can exercise an option to acquire ownership of the hired goods (as in the *Transag* case) or to become contractually entitled to a sum little less than their sale proceeds (as in this case)? And on the unusual facts of this case, could the court grant any relief after the sale under the order of Harman J?

The deputy judge addressed these questions at two points in his judgment [1999] 2 All ER 811 , 819–820, 826–827. In the first passage he stated the terms on which On Demand was seeking relief:

“there should be paid to [Michael Gerson] such a sum as [Michael Gerson] would have been entitled to if sale of the equipment under condition 12(A) had taken place, assuming for this purpose a sale at £251,617 and tax advantages totalling £15,897.”

(Those figures were agreed by On Demand in order to have the motion treated as the trial of the action. The deputy judge must also have had in *173 mind that any outstanding sums for primary or secondary rentals would be paid.)

The practical effect of granting relief on those terms would have been, as I understand it, that the actual sale proceeds of the equipment (about £132,000) would have been divisible (very roughly) as to one-quarter to Michael Gerson and as to three-quarters to On Demand. Sir Roy described that as On Demand obtaining relief by paying Michael Gerson some of its (Michael Gerson's) own money.

The deputy judge then went on (under the heading “Alleged jurisdiction to amend terms of agreement”) to consider the implications of the terms of the finance leases: that the sale agency under condition 12 arose only after the termination of the lease (and “subject to the lessee having duly performed its obligations under this agreement and any other lease agreement”), and that the lease could be terminated only by at least 60 day's notice expiring at the end of the primary period, or on a later anniversary. He said [1999] 2 All ER 811 , 819–820:

“If no receivership had arisen (and if there had been no other breaches of the agreements), I cannot see that there would have been any right to ask the court to intervene to authorise a sale of the equipment while the leases were still on foot in circumstances where [Michael Gerson] had acquired no right, and might never have acquired the right, to sell under condition 12. Such an intervention could be justified only on the basis that the court possesses a general jurisdiction to rewrite contracts. I have no doubt that there is no such general jurisdiction.”

The deputy judge then considered what he called an example, that is a hypothetical situation in which a lessee on the same terms as the finance leases was simply seeking reinstatement of the lease, so that the lessee could proceed to give a 60-day notice to terminate the lease, sell under the agency in condition 12 and claim a sum equal to 95% of the net proceeds. After considering the law, including the *Transag* case, the deputy judge concluded that, had the equipment not been sold, he would have granted relief. In view of his observations about not rewriting contracts it seems clear that that would have meant no more than the reinstatement of the finance leases, not the acceleration of the opportunity to sell the equipment and obtain the financial advantage of the sale.

That is confirmed by what the deputy judge said when he returned from the hypothetical example to the actual facts [1999] 2 All ER 811 , 826:

“In the present case, the equipment is no longer in the possession of the plaintiff lessees. It has been sold. Relief from forfeiture would therefore not make sense: first, a lease of equipment cannot meaningfully be restored if the equipment is gone; second, the possession of the lessee of the equipment cannot be restored to the lessee if there is no longer any equipment to possess. If the plaintiffs had confined themselves before Harman J to asking for the finance leases to be restored as if they had never been forfeited, the court might well have been prepared to grant relief, perhaps on terms. They asked instead for leave to sell the equipment, all the defendant's rights being reserved. One of the defendant's rights in my judgment is to argue that as the grant of relief could not now restore the status quo, there cannot be jurisdiction to grant *174 it. Restoration of the status quo includes restoration of a state of affairs whereby the lessee has either: (i) to pay the secondary rentals and abide by the other terms of the agreement if it wishes to continue to use and possess the equipment; or (ii) to comply strictly with the 60-day notice provision and the terms of condition 12 if it wishes to be entitled to sell as the owner's agent. Neither of those possibilities would any longer exist if relief from forfeiture were now purportedly granted. Accordingly, in my view, there can be no jurisdiction to grant it”

Dr Oditah has submitted that the deputy judge was wrong in that conclusion. There were three main strands in his argument: that the jurisdiction to relieve from forfeiture is very wide and did not depend on the precise reconstitution of the relationship

of lessor and lessee; that the acceleration of the opportunity for sale under condition 12 did not amount to rewriting the contract; and that the sale under the order of Harman J should be seen as purely facultative and “merits-neutral”. On the first of these points Dr Oditah referred to the observations of Steyn LJ in *Securities and Investments Board v Pantell SA (No 2) [1993] Ch 256*, 283, citing *Birks, An Introduction to the Law of Restitution* (1985), p 423. On the second point he cited the decision of this court in *Lancashire Waggon Co Ltd v Nuttall (1878) 42 LT 465* and that of Judge Rich QC in *Alf Vaughan & Co Ltd v Roy Scot Trust plc [1999] 1 All ER (Comm) 856*. On the third point he cited *Larner v Fawcett [1950] 2 All ER 727*.

As to the first point, I readily accept that (as Professor Birks puts it) equity does not insist on exact counter-restitution but is willing to make adjustments in money, so long as the results are practical and just. The Court of Chancery, unlike common law courts, had the machinery for taking accounts on which such adjustments could be based. But Dr Oditah's beguiling formulation of “precise reconstitution” not being required tends to obscure the fact that (as Sir Roy Goode put it) there would be nothing left of the finance leases except for a few lines of condition 12(A). The decisions of the House of Lords discussed at length earlier in this judgment all insist that the equitable jurisdiction is to relieve against the forfeiture of *property*, not to rewrite bargains (especially commercial bargains). The money paid into the escrow account might be regarded as a clean substitution for the equipment (though that is open to argument, since Michael Gerson contended for a sale at an undervalue, and On Demand accepted that contention). But I cannot see how the court could then grant relief from forfeiture in relation to a sum of money after the equipment had gone. As Dillon LJ said in *Fuller v Judy Properties Ltd (1991) 64 P & CR 176*, 184, the object of relief against forfeiture is the continuation of a lease, not its extinction.

As to *Lancashire Waggon Co Ltd v Nuttall 42 LT 465*, it establishes that the court will permit accelerated payment by the hirer (or deferred purchaser) if the provision for periodical payments was solely for the hirer's (or purchaser's) benefit. In view of the importance of the tax element in finance leases, and in the absence of any finding on this point by the judge (who did not, I think, hear argument on it), I would not assume that the relevant provisions of the finance leases were inserted solely for the benefit of On Demand.

***175**

In *Larner v Fawcett [1950] 2 All ER 727* the owner, F, of a thoroughbred filly agreed to lease the filly to D, who placed her with a trainer, L. D failed to pay for the filly's keep and L obtained judgment against him. The issue was whether, as between L and F, L was entitled to a common law lien (which gave no right of sale). This court upheld an order for sale of the filly (under what became *RSC, Ord 29, r 4* and is now *CPR, r 25.1(c)(v)*) on the footing that the lien, if established, would attach to the proceeds of sale. That order was “merits-neutral”. In this case, by contrast, the sale inevitably altered the court's power to grant relief.

I reach this conclusion with some regret, but I am not convinced that the result is as deplorable as some commentators have suggested. The finance leases were familiar commercial transactions between substantial companies in which the court would not assume transactional inequality. Michael Gerson may have obtained a windfall but the receivers achieved their larger objective, that is the sale of On Demand's Creative Convergence division as a going concern. The deputy judge (who was closer to the economic and tactical realities of the matter than this court can be, although not so close as Harman J was on 5 March 1998) said *[1999] 2 All ER 811*, 826 that On Demand “took their chance” in asking the court to sanction a sale. Dr Oditah is correct in pointing out that the risk was not that the court might not “validate” the sale, but that relief from forfeiture (so as to enable On Demand to benefit from condition 12) would no longer be possible.

In my judgment that risk has proved fatal to *On Demand's* case. To hold otherwise would to my mind require the court to extend the doctrine of equitable relief from forfeiture in an unprecedented way, and moreover in a way which would introduce unacceptable uncertainty into commercial transactions. I would therefore dismiss this appeal.

SIR MURRAY STUART-SMITH

I gratefully adopt the statement of facts set out in the judgment of Robert Walker LJ. The judge held that but for the sale of the equipment the court would have had jurisdiction to grant relief from forfeiture and, in the exercise of its discretion, would have done so on payment of the outstanding primary rental on lease No 4, namely £3,892.54, 5% of the sale price which was taken to be £251,617 (£12,580) and any sum to which the respondents, Michael Gerson, were entitled by way of tax relief, which seems to have been taken at £15,897 (but as to which there is some dispute between the parties as to the correct figure). In this appeal the appellants, On Demand, contend that the judge was wrong in holding that the sale defeated the claim for relief from forfeiture.

But Michael Gerson in their respondent's notice contend that the judge was wrong in holding that, but for the sale, the court had jurisdiction to grant relief from forfeiture. Two principal arguments have been advanced by Sir Roy Goode on their behalf: (i) that the court has no jurisdiction to grant relief from forfeiture in ordinary commercial contracts unconnected with interests in land; (ii) that, if the court does have jurisdiction in relation to contracts other than those involving interests in land, it is confined to cases where there is a grant of a proprietary interest; a possessory interest is not sufficient.

I propose to deal with these points shortly because I am in agreement with the views of the judge on them: I have also had the advantage of reading in [*176](#) draft the judgments of Robert Walker and Pill LJJ and I agree with them on these issues. In my view the first submission is not open to Michael Gerson in this court. In *BICC plc v Burndy Corpn [1985] Ch 232* it was held by this court that the jurisdiction to grant relief from forfeiture arose in relation to a proprietary or possessory right in personal property, in that case intellectual property. Secondly, while it may be true, as Sir Roy asserts, that there is no case where a purely possessory right has been held to be sufficient, there are now a number of statements of authority that either a proprietary *or* possessory interest is enough: see *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade) [1983] 2 AC 694*, 702 per Lord Diplock and the *Court of Appeal in BICC plc v Burndy Corpn [1985] Ch 232*, 252a per Dillon LJ, the other members of the court agreeing with his judgment.

In my judgment the real question in this appeal is whether the judge was right to hold that the sale of the equipment defeated On Demand's claim for relief from forfeiture because On Demand could not be restored to the position before the leases were terminated. In my opinion the answer to the question depends on the proper construction and effect of the order of Harman J made on 5 March 1998. This has to be determined in the light of the facts and circumstances known to the parties and the judge at the time. By their writ On Demand sought relief from forfeiture and an order for sale; the same relief was sought on the notice of motion; the order for sale being sought was an interim order pursuant to the provisions of [RSC Ord 29, r 4](#). That rule provides:

“(1) The court may, on the application of any party to a cause or matter, make an order for the sale by such person, in such manner and on such terms (if any) as may be specified in the order of any property (other than land) which is the subject matter of the cause or matter or as to which any question arises therein and which is of a perishable nature or likely to deteriorate if kept or which for any other good reason it is desirable to sell forthwith.”

It was never in dispute that there was good reason why it was desirable to sell the equipment forthwith. Both On Demand and Michael Gerson were anxious to sell to the management buyout, since the price thereby obtained was substantially higher than that obtainable on a breakup.

It seems to me to be plain that the object of the rule is to substitute for the property itself the proceeds of sale so that the parties can argue their rights as they existed at the time of the application on the basis of what the position would then have been. It is certainly to my mind a bizarre result that the very sale itself defeats one of these parties' rights. But this is what the judge held.

That this never occurred to the parties or the judge at the time of the making of the order seems to me to be equally plain. In his letter of 2 March 1998 Mr Gerson wrote on behalf of Michael Gerson:

“I confirm our conversation of this morning when I put forward the suggestion that without prejudice to the terms and conditions of our four leases and the rights existing under those leases, that in order to enable the best realisable price to be negotiated, in the interest of saving jobs at the company, and to preserve any goodwill, you should negotiate a sale to *177 any interested party with which we will co-operate as owner (but without our conferring any warranty as to condition or use of the goods) subject to agreement on price with our valuer and that the proceeds of sale should be paid into an escrow account giving you the option to apply to the court in accordance with the principles set out in [*Transag Haulage Ltd v Leyland DAF Finance plc* [1994] 2 BCLC 88] to which you referred, within a period of 60 days and with you bearing all the costs of the action in order to obtain clarification of the law”

In his affidavit sworn on 5 March 1998 Mr Gerson made it clear:

“(i) that [Michael Gerson] wished to sell the equipment at the best achievable price” (para 3);

(ii) “that while [Michael Gerson] did not accept that [On Demand] had any right to relief from forfeiture. They accepted that there was an arguable case that they did” (para 4);

(iii) “that in order to hold the position pending a full hearing of the motion, the proceeds of sale should be put into an escrow account as contemplated by the notice of motion. However [Michael Gerson] wish to reserve their right in relation to such sales... It should be clear on the face of the order that it is made without prejudice to [Michael Gerson's] contention that it is entitled to the full value of the goods at the date of sale” (para 5).

Michael Gerson consented to an order for sale which “did not prejudice their rights to raise arguments as to the true value of the equipment in due course”.

The dispute between the parties was whether the sale price, on which the 5% was to be calculated, was that attributed to it in the proposed management buyout, namely £130,500 (or £132,839.96) or £251,617—the value attributed on a going-concern basis by Michael Gerson's valuers. The order of Harman J reflected that; it was in these terms:

“The plaintiffs and each of them be at liberty to sell or otherwise dispose of the equipment the subject of the finance lease agreements specified in the schedule hereto and give a good and valid title to the purchaser or disponent free from any claim by the defendants or either of them upon the terms that the net proceeds of the said sale or disposition be held in an escrow account pending the hearing of the inter partes motion on notice in this action, provided that the defendants shall be at liberty hereafter to contend that the breakup value of the said equipment was more than £130,500.”

The order is not expressed to be without prejudice to Michael Gerson's right to contend that there was no right to relief from forfeiture at that time. But Dr Oditah on behalf of On Demand accepts, rightly in my view, that this is implicit in the order. Both Dr Oditah and Mr Tomlinson have made it plain that neither of them ever contemplated at that time that the sale of itself could defeat the application for relief from forfeiture. There is nothing to suggest that the judge contemplated the possibility. Such a result was wholly antithetical to what was sought, what was consented to and what was ordered. Had the point been raised, the judge would have had to determine the application for relief from forfeiture before making any order for sale. Assuming that Harman J would have decided the matter at that *178 time in the way Mr Laurence QC said he would have done but for the sale, relief would have been granted on terms. In my judgment it is amply borne out by what happened before Harman J, the transcript of which we have now seen. In his short judgment Harman J makes it plain that in his view “relief

from forfeiture is obviously available”. Had he in fact granted relief there and then, there would have been no problem. Had that been done, it is apparent, it seems to me, that Michael Gerson would have consented to the sale on the same terms that they in fact did. They obviously they would not have insisted on a 60-day notice, since they too were anxious to sell to the only purchasers in the market. In the unlikely event that Michael Gerson had insisted on a 60-day notice, it would I think have been possible to agree a sale with the purchaser, contingent on the giving of the notice and payment of the price on expiry of the notice. But that was not what either party wanted.

The order is wholly silent on the question of the parties' rights in relation to relief from forfeiture. But in the same way that I accept that it is implicit in the order that Michael Gerson could maintain on the final hearing of the motion that as at the date of the application there was no right to relief—because for example relief only related to interests in land and not to possessory interests in personal property—so it seems to me to be implicit in the order that the rights of the parties were to be considered as at that date and not be affected by the order for sale itself. In the light of hindsight, it would have been better had this been spelt out in the order itself. But I see no reason why the court should not so construe the order that this is implicit in it. At the time, had the matter been raised, it seems to me both parties and the judge would have said, “Of course that is what we mean”

That this is the purpose and intent of [Ord 29, r 4](#) is I think borne out by [Larner v Fawcett \[1950\] 2 All ER 727](#). The facts of the case are that F agreed with D that D should take F's filly on lease for a certain period on terms that money won on racing should be shared between them. D was responsible for the upkeep and he should have a right to buy at any moment. D agreed with L that L should train the horse. F learnt that L had the horse and that D owed money for its upkeep for which L was suing D. F wrote to L asking him to “hold the filly on behalf of” F and that he would be responsible for my expenses in connection therewith. But F later withdrew this. L started an action against F for a declaration that he was entitled to a lien on the filly in respect of her upkeep. He also sought an order for sale of the filly pending determination of his right to a lien against F. The order was sought under [RSC \(1883\) Ord 50, r 2](#), which is in substantially the same terms as [RSC \(1965\) Ord 29, r 4](#). The Court of Appeal upheld the judge's order for sale. L had only a possessory lien; once he lost possession of the horse, he could no longer exercise his lien. It would have been absurd and defeated the whole object of the order if it had had the effect of putting an end to the lien so that he could not maintain his claim when the case came to trial. It is clear that, when the court came to consider whether L had a lien, it was to do so as at the time of the application and not at the time of the trial hearing.

Sir Roy Goode submitted that this argument was in the nature of a plea of estoppel, and there was no such plea in the reply and defence to counterclaim. I do not think there is any question of estoppel. Rather it is a question of construing the order of the court in the light of the facts known [*179](#) to the parties and the court at the time it was made. The judge's decision seems to me to be very unjust to the claimants. It is common ground that the rentals payable over 36 months cover the cost of the equipment, interest and profit, so that apart from the final instalment on the fourth lease of £3,892.54 (which would be payable if relief is granted) Michael Gerson had already recovered their full outlay plus profit. Once the primary period is over, the lessee has a valuable right, albeit a contractual and not a proprietary right, to continue leasing at a nominal rental or to sell as agent for the lessor and retain 95% of the purchase price. If relief is granted on the terms proposed by the judge, Michael Gerson get everything they are entitled to under the leasing agreements. Indeed they get accelerated payment, but, provided no attempt is made to obtain a discount for accelerated payment, that does not prevent relief. Michael Gerson cannot insist on the letter of the agreement if they suffer no detriment: [Lancashire Waggon Co Ltd v Nuttall 42 LT 465](#).

If the law requires the court to reach a conclusion which confers a substantial windfall on Michael Gerson and this injustice on the claimants, so be it. But for the reasons which I have endeavoured to explain, I do not think it does.

PILL LJ

I agree with the conclusion of Robert Walker LJ on the first issue and for the reasons he gives. That there is jurisdiction to grant relief from forfeiture in the case of finance leases emerges from the speech of Lord Wilberforce in *Shiloh Spinners Ltd v Harding* [1973] AC 691, 723, cited by Robert Walker LJ:

“it remains true today that equity expects men to carry out their bargains and will not let them buy their way out by uncovenanted payment. But it is consistent with these principles that we should reaffirm the right of courts of equity in appropriate and limited cases to relieve against forfeiture for breach of covenant or condition where the primary object of the bargain is to secure a stated result which can effectively be attained when the matter comes before the court, and where the forfeiture provision is added by way of security for the production of that result.”

A finance lease is in principle capable of attracting relief from forfeiture. Michael Gerson's real interest in these leases was a financial one and the forfeiture provision was added by way of security for the production of that result.

That conclusion gives rise to a series of questions as to the circumstances in which relief can arise and as to the form that relief can take. Submissions have also been made upon the different but related question as to the rights of the lessee during the currency of the lease. Dr Odiah relies upon the flexible approach adopted by the courts when the interest of the vendor or lessor is only financial. In *Lancashire Waggon Co Ltd v Nuttall* 42 LT 465 it was held that a contract on what was described as the “sale on hire system” was in effect one of sale and the provision for payment by instalments was a provision solely in favour of the purchaser. In these circumstances, the purchaser was entitled to anticipate the time fixed for the transfer of the property in the wagons by anticipating the time for payment. In the case of a finance lease on the present terms, it is submitted, the court **180* should permit the lessee to terminate the agreement and, upon a forfeiture, to grant relief and permit sale, provided the financial interests of the lessor are protected.

The somewhat elaborate provisions for termination in the agreement including clause 12 (A to E) should not be used to curtail or obstruct the exercise of the lessee's rights. The lease makes detailed provision for the sale of the equipment upon termination of the lease. It is sufficient for present purposes to set out clause 12(A):

“Subject to the lessee having duly performed its obligations under this agreement and any other lease agreement upon termination of the leasing of the equipment at the end of the primary period or at any time thereafter by notice from the lessee in accordance with the provisions of this agreement, the lessee is appointed the sales agent of the owner to negotiate a sale of the equipment to a third party (not being a parent, subsidiary or associated company of the lessee) at the best price available, such price to be negotiated to and approved by the owner prior to the sale”

The lease also requires, as Robert Walker LJ has pointed out, 60 day's notice of termination by the lessee.

Sir Roy Goode relies on the principle that equity expects men to carry out their bargains. The terms of the contract, including clause 12, are framed to meet the interests of both parties which include that of achieving the most favourable treatment for the purposes of tax. The lessee is not entitled to buy out the interest of the lessor as and when it sees fit. Nor, upon obtaining relief against forfeiture, if the court has power and does grant relief, can the lessee as a matter of course circumvent the provisions of the lease to achieve a sale.

It is not necessary for the determination of this appeal to resolve the more general questions which arise. That is because a sale of the equipment to a third party was proposed by On Demand. Their solicitor's letter of 2 March 1998 referred to the “purported” forfeiture and stated:

“In those circumstances, but for the appointment of joint administrative receivers to the company, the economic benefit which Michael Gerson (Finance) plc could expect to derive from the lease agreements would amount to the unpaid rent referred to above, together with 5% of the net sale proceeds upon a sale being negotiated by the company. We understand that the assets the subject of the lease agreements have a material value, possibly exceeding £130,000. In those circumstances, we have advised our clients that, on the basis of the equitable principles outlined in the recent case of *Transag Haulage Ltd v Leyland DAF Finance plc* [1994] 2 BCLC 88, our client is entitled to make application to the court for relief from the forfeiture of the lease agreements and an order that the company may exercise its rights as your agent to sell the assets the subject of the lease agreements in accordance with the provisions of clause 12(A) and 12(E) of the lease agreements, thereby preserving the company's clear interest in the proceeds of sale of the leased equipment. As you are aware, our client is seeking purchasers of the company's business as a going concern and would seek to include the assets the subject of the leased agreements within any such **181* transaction. Could you please confirm by return of fax and in any event by 3pm this afternoon that our clients may proceed to negotiate such a sale as envisaged by clause 12 of the lease agreements, failing which our clients will make application to the court for the relief referred to above and an order that you pay the costs of such application, without any further notice to you whatsoever”

The proposed sale had the urgent and larger object of keeping the business going. Michael Gerson agreed to the sale and Harman J made an order authorising the sale. A proviso to the order left Michael Gerson free to contend that the value of the equipment was more than the £130,500 for which it was to be sold.

That sale having occurred, I agree with Robert Walker LJ that the court cannot grant relief from forfeiture in relation to the sum of money obtained on the sale. On Demand are no longer lessees claiming relief. Whatever flexibility may be shown by the courts in granting a lessee relief from forfeiture, it does not in my judgment extend to a claim upon a sum of money obtained on sale of the leased equipment following a resolution of the matter by sale of the equipment at the request of the lessee.

The argument which, as I understand it, has commended itself to Sir Murray Stuart-Smith is that the order for sale in this particular case reserved to On Demand the right to apply for relief against forfeiture, notwithstanding the sale, as if they were still lessees. It was an implied term of the order, it is suggested, that the rights of the parties were, upon a subsequent application for relief against forfeiture, to be considered as at the date of and unaffected by the order for sale.

To the extent that the argument turns upon the construction of the order made by Harman J, I agree with Sir Murray Stuart-Smith. It would be open to parties to agree that, notwithstanding a sale, their rights should be determined as if a sale had not occurred. I do not exclude the possibility that the circumstances might be such that an agreement to that effect could be implied. I am, however, unpersuaded that such an agreement can be implied in present circumstances. It would have been open to On Demand to seek from Harman J relief against forfeiture. Questions could then have arisen, for example, as to whether the contractual requirement of 60 day's notice to terminate was a bar to immediate sale. On Demand took an alternative course for what appeared to them to be good commercial reasons. In the absence of agreement by Michael Gerson, they could not have both the sale they sought and the right to claim relief against forfeiture as if they had not taken that course.

On Demand argue, and Dr Oditha has done so forcefully on their behalf, that sale is not as a matter of law a bar to their money claim but that is quite different from the argument that relief can be sought as if there had not been a sale. I find nothing to justify a finding that Michael Gerson agreed to the latter arrangement.

By agreeing that On Demand retained the “option to apply to the court in accordance with the principles set out in the *Transag Haulage* case” Michael Gerson were not agreeing that the point could be argued as if no sale had occurred. Had that suggestion been made at the hearing before Harman J, which it was not, Michael Gerson would have been startled. Consideration of

the transcript of the hearing before Harman J in my view **182* supports the conclusion that there was no such agreement. There is no record of a suggestion by Dr Oditah at that hearing that there was any such agreement. The submissions to the judge were directed mainly to whether the proviso to the proposed order which Michael Gerson were seeking (“provided that [Michael Gerson] shall be at liberty hereafter to contend that the break-up value of the said equipment was more than £130,500”) was necessary or appropriate. Mr Tomlinson, for Michael Gerson, initially submitted that:

“the position is this that, on the face of the matters, we are the owners of the equipment, entitled to possession, subject to an arguable right to relief from forfeiture. The effect of this order is to transfer, against our will, the ownership of goods that is presently vested in us. My Lord, we can see the common sense of that in the circumstances that have arisen, but what we say is simply this—that no order should be made which has the effect of definitively depriving us of our rights in relation to those goods.”

He added that: “what [the order for sale] would have the effect of doing is transferring our rights from the goods to the proceeds of sale that they say they have.” He went on to argue for the proviso. Dr Oditah's submissions were directed to the same point. In the course of argument, the judge stated:

“How does that prejudice you Dr Oditah? You will have in your hands, as receivers, the whole of this fund, you will be able to seize the running loss of the wages and loss in the business which is one of the things you will urgently need to do, I understand that. You will be entitled to retain the fund until this was determined as against your appointing back the debenture holder.”

Dr Oditah opposed the insertion of the proviso.

In his judgment, the judge stated:

“This is an ex parte application on notice in an action which I think has now been started but was an intended action when brought before me yesterday. The intended defendants”—Michael Gerson—“have appeared. They say that the matter is coming on with extreme speed and that they are not in a position to definitively establish their position. That seems to me a perfectly reasonable attitude. The order sought by the ex parte application is that the plaintiffs”—On Demand—“who are two companies in administrative receivership, be at liberty to sell equipment, the subject of financial disagreements which are specified, and to give a good and valuable title to the purchaser or donee, free from any claim by the defendants or either of them. So far, no opposition is made to the follow-up from the order upon the terms that the net proceeds of the said sale be held in an escrow account pending the hearing of the inter partes motion.”

In the course of considering the differing evidence as to value, and concluding that the difference was very small, the judge did say that “relief from forfeiture is obviously available”. I read his comment as indicating that in his view relief was at that stage available and not as indicating a view, still less an agreement, that it would survive the sale.

**183*

Finding that it was appropriate to make the order, Harman J stated:

“It seems to me the order will enable the plaintiffs to sell and to give good title, to put an end to the running liability for wages which is causing loss to the debenture holder, eventually, the creditors eventually of the companies and will effectively discharge the difficulty which they are facing at the moment. On the other hand, the defendants will be protected by the insertion of the proviso and it seems to me the plaintiffs are not caused any substantial prejudice thereby.”

Agreement by Michael Gerson that On Demand could sell but must be treated as if they were still lessees would have involved a substantial concession. It would have been a most unexpected concession in circumstances in which it was On Demand who were making the running towards achieving a sale. I have found nothing to suggest that Michael Gerson entered into any such agreement or that such an agreement can be implied in the circumstances.

On Demand had recourse to the court and invited the court to exercise its power, as an interim remedy, to order the sale of relevant property. The existence of that power is not doubted but its exercise does not in my judgment bear upon the question whether, in subsequent proceedings, the parties are to be treated as if their relationship was as it existed at the date of the interim order and as if the order had not been made.

For these reasons, as well as those stated by Robert Walker LJ, I would dismiss this appeal.

J R S

Representation

Solicitors: Walker Morris, Leeds; Royds Treadwell .

Appeal dismissed. Defendants to have 60% of their costs. Interim order for costs in sum of £12,000, subject to assessment, to be paid within seven days. Permission to appeal refused.

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Exhibit 7

*621 Orion Finance Ltd v Crown Financial Management Ltd



Positive/Neutral Judicial Consideration

Court

Court of Appeal (Civil Division)

Judgment Date

21 December 1995

Report Citation

[1996] B.C.C. 621

Court of Appeal (Civil Division)

Sir Stephen Brown P , Millett , Otton , Swinton Thomas and Pill L JJ.

Judgment delivered 21 December 1995, and 29 July 1996

Assignment of book debts—Whether assignment was by way of charge and registrable—Whether avoidance of assignment for non-registration meant assignee had no claim against lessee— [Companies Act 1985, s. 395](#) .

This was an appeal against a decision of Vinelott J ([\[1994\] B.C.C. 897](#)) that an assignment of book debts forming part of complex financing arrangements was by way of security and was registrable as a charge on book debts and not having been registered was void against administrative receivers and liquidators.

The appellant, Orion Finance Ltd ('Orion'), sued the respondent, Crown Financial Management Ltd ('Crown') for rent payable under a lease of computer equipment made between Atlantic Computer Systems plc ('Atlantic') and Crown and assigned to Orion. After the assignment to Orion had taken place it was agreed between Atlantic and Crown that Crown should have the right to terminate the lease without penalty before the full period of the lease had expired. Crown later exercised its option to terminate the lease. Orion claimed payment from Crown of the rent which fell due after it had done so. This raised the question whether the right to terminate the lease was a term of the lease binding on Orion or was part of a separate arrangement between Atlantic and Crown under which on the exercise of the option Atlantic undertook to discharge Crown's liability to pay the remaining rentals due under the unexpired term of the lease to Orion. The question was important to Crown because Atlantic was unable to meet its obligations being in administrative receivership and liquidation.

Vinelott J held that Crown's right to terminate the lease was not binding on Orion and that the assignment to Orion constituted a charge over book debts of Atlantic which was registrable under [s. 395 of the Companies Act 1985](#) and, not being registered, was void against the administrative receivers and liquidators of Atlantic. He held further that this provided a complete defence to Orion's claim under the lease and dismissed the action.

The questions on appeal were (1) whether the assignment of the rent to Orion was by way charge, and if so (2) whether the invalidity of the assignment against the administrative receivers and liquidators of Atlantic afforded Crown a defence to Orion's claim.

Held , dismissing the appeal:

1. The structure of the financing arrangements and the language in which they were expressed compelled the conclusion that the assignment was by way of security. The acquisition of the equipment by Atlantic was financed by hire-purchase, not by the sale of rents to fall due under the lease. The principal document was the hire-purchase agreement of which Atlantic's obligation to assign the lease rentals formed an integral part. The purpose of the assignment was not to finance the purchase of equipment but to provide the mechanism by which Orion's right to receive the instalments of hire was without recourse to Atlantic. If Atlantic was regarded as financing the acquisition of the equipment by means of the outright sale of the rents, it was difficult to see what function was performed by the hire-purchase agreement.

2. The assignment was made in consideration of the hire-purchase agreement and because the hire-purchase agreement required it, the hire-purchase agreement described Orion as 'the owner' at a time when the assignment had not been made. It assumed that Orion had acquired the equipment outside the financing arrangements which it embodied. The structure of the transaction was of a hire-purchase agreement coupled with a non-recourse charge of the lease rentals to secure the payment of the instalments of hire.

*622

3. The assignment of the lease rentals was registrable as a charge of Atlantic's book debts and not having been registered was void against the administrative receivers and liquidators of Atlantic.

4. The inevitable concession that the administrators and liquidators were entitled to the rent before the expiry of the fifth year of the term, when Crown had the right (the 'walk option') to terminate the lease, was fatal to Orion's case. There was no material distinction between the rent due before and after that date. It might at first sight appear curious that s. 395 could operate for the benefit of a lessee and not the insolvent estate, but that was the result of the invalidity of the assignment once Crown exercised the right to terminate the lease, and not the effect of the section.

The following cases were referred to in the judgment of Millett LJ:

Inglefield (George) Ltd, Re [1933] Ch 1 .
Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd [1992] BCLC 609 .
Paul & Frank Ltd v Discount Bank (Overseas) Ltd [1967] Ch 348 .
Saunderson & Co (in liq.) v Clarke (1913) 29 TLR 579 .
Stein v Blake [1995] B.C.C. 543; [1996] 1 AC 243 .
Welsh Development Agency v Export Finance Co Ltd [1992] B.C.C. 270 .

Representation

John Martin QC and James Ayliffe (instructed by Berwin Leighton) for Orion Finance Ltd.
Jules Sher QC and Christopher Pymont (instructed Simmons & Simmons) for Crown Financial Management Ltd.

Millett LJ:

JUDGMENT

(Delivered 21 December 1995)

This appeal raises a familiar question which has caused problems before and no doubt will cause problems again. It is whether an assignment of book debts forming part of complex financing arrangements is by way of security or should be characterised as an outright sale with an option to repurchase.

By the action the appellant, Orion Finance Ltd ('Orion'), sued the respondent, Crown Financial Management Ltd ('Crown') for rent payable under a lease of computer equipment made between Atlantic Computer Systems plc ('Atlantic') and Crown and assigned to Orion. After the assignment to Orion had taken place it was agreed between Atlantic and Crown that Crown should have the right to terminate the lease without penalty before the full period of the lease had expired. Crown later exercised its option to terminate the lease. Orion claimed payment from Crown of the rent which fell due after it had done so. This raised the question whether the right to terminate the lease was a term of the lease binding on Orion or was part of a separate arrangement between Atlantic and Crown under which on the exercise of the option Atlantic undertook to discharge Crown's liability to pay the remaining rentals due under the unexpired term of the lease to Orion. The question was important to Crown because Atlantic is unable to meet its obligations. It is in administrative receivership and liquidation.

Vinelott J held ([1994] B.C.C. 897) that Crown's right to terminate the lease was not binding on Orion. There is no appeal from this part of his decision. But he also held that the assignment to Orion constituted a charge over book debts of Atlantic which was registrable under s. 395 of the Companies Act 1985 and, not having been registered, was void against the administrative receivers and liquidators of Atlantic. He held further that this provided a complete defence to Orion's claim under the lease and accordingly dismissed the action. Orion appeals from these parts of the judge's decision.

Two questions arise on this appeal:

- (1) whether the assignment of the rent to Orion was by way of charge; and if so *623
- (2) whether the invalidity of the assignment against the administrators and liquidators of Atlantic affords Crown a defence to Orion's claim.

We have heard argument on the first question only, and have adjourned the appeal for argument on the second question should it become necessary.

The facts

The facts are fully set out in the judgment of Vinelott J. They may be summarised as follows. Atlantic was prominent in the business of leasing computers. It would buy or contract to buy the equipment which its customer wanted and would negotiate the terms of a lease of the equipment to the customer. At the same time it would approach a number of parties to finance the transaction. They would be asked to quote the price which they would pay to take over the benefit of the rental stream, either with or without recourse to Atlantic. One of the funders which provided finance to Atlantic was Orion, an indirect subsidiary of the Royal Bank of Canada. If Orion was the selected funder it would make an offer conditionally on being satisfied as to the financial standing of the customer. If it accepted the transaction it would acquire the equipment (either direct from the supplier or more frequently from Atlantic), enter into a hire-purchase agreement with Atlantic and pay the agreed sum to Atlantic on production of the necessary documents. These included the lease to the customer, an acceptance note signed by the customer confirming that the equipment had been delivered, an assignment by Atlantic to Orion of the rents due under the lease, and a copy of the notice of the assignment given to the customer.

There were two principal categories of hire-purchase agreement which were in use between Orion and Atlantic. If Orion was satisfied with the financial standing of the customer it would accept the assignment of the rents in satisfaction of the instalments payable by Atlantic under the hire-purchase agreement. An agreement of this kind was known as a 'non-recourse agreement'. Under it Orion would bear the risk that the customer might be unable to meet the rental payments under the lease and would have no recourse against Atlantic for the hire-purchase instalments in the event of the customer's default. If Orion was not satisfied with the financial standing of the customer it would not accept the assignment of the rents under the lease as discharging Atlantic's liabilities under the hire-purchase agreement. It would then retain a right of recourse against Atlantic for the hire-purchase rentals if the customer failed to pay the lease rentals. An agreement of this kind was known as a 'full recourse agreement'.

There was, however, a third kind of agreement known as a 'limited recourse agreement'. This was a refinement of the non-recourse agreement. Under it the hire-purchase agreement would provide for the amount of the hire-purchase instalments to be varied if the market rate of interest measured by an agreed formula varied from the rate of interest which had been assumed

by Orion in valuing the stream of rental payments. In such a case Orion retained a right of recourse to Atlantic for any sums which might become due it as a result of changes in interest rates, but in all other respects the agreement was without recourse.

The hire-purchase agreement

The hire-purchase agreement in the present case took the form of a limited recourse agreement. It is a very elaborate document. It covers equipment leased to another customer as well as equipment leased to Crown. It is unnecessary to refer to all its terms. It is made between Orion, described as 'the owner', and Atlantic, described as 'the hirer'. The total purchase price of the equipment is given as £1,898,459 plus VAT. The term of the hiring by Atlantic is the same as the term of the lease to the customer, that is to say seven years, and the equipment is described by reference to the lease. The first instalment *624 of hire is £31,137.63 and the subsequent instalments match precisely in amount and date the rentals payable under the lease. There is provision for the adjustment of the quarterly instalments by reference to the difference between 11.5 per cent and a market rate ascertained by a given formula. Orion consents to Atlantic sub-letting the equipment to Crown on the terms of the annexed lease; the annexed lease is a copy of the lease to Crown and signed by Crown but without the option to terminate during the term.

Clause 7 provides for the assignment of the rentals payable under the lease. It is in the following terms:

'7. Assignment:

The hirer, *as security for its obligations hereunder*, shall assign to the owner under the terms of a deed of assignment all moneys now or hereafter to become payable to the hirer under the lease to the intent that *they be charged* with the payment of all moneys now or hereafter owing to the owner under this agreement except that *such security* and assignment will not *encumber* or 'extend to:

(I) any moneys payable under the lease in respect of VAT; or

(II) any amounts payable under the lease on voluntary termination in excess of any amounts payable by the hirer on voluntary termination of this agreement.

To the extent that the owner receives any such excepted payments the owner shall forthwith pay them to the hirer.' (emphasis added.)

Clause 8 contains the limited recourse provisions. It is in the following terms:

'8. Liability for hire purchase instalments

(A) Subject as set out below, the hirer shall pay the owner the instalments set out in Pt. II of the Schedules hereto, adjusted as necessary by the application of Pt. III thereof.

(B) The owner hereby acknowledges that the moneys assigned *under the security* granted to the owner under cl. 7 hereof shall be in satisfaction of the hirer's obligations in respect of the instalments set out in Pt. II of the Schedules save that nothing in this cl. 8(B) shall be taken as satisfying the hirer's obligations to pay the difference between the rentals under the lease and the hire purchase instalments set out herein but so that the obligation of the hirer to pay such difference shall continue only for so long as the rental payments are duly paid under the lease.'

Clause 14 contains elaborate provisions for the termination of the hire-purchase agreement. It is sufficient for present purposes to summarise them. Clause 14(A) deals with the voluntary termination of the agreement by the hirer; cl. 14(B) with the

consequences of total loss of the equipment; cl. 14(C) with termination on default by the hirer; and cl. 14(D) with termination on default by the sub-lessees.

Clause 14(A) gives the hirer the right at any time after the first anniversary of its commencement to terminate the hire-purchase agreement by giving the owner not less than three months' notice of its intention to do so. Upon the hirer's voluntary termination of the agreement the hirer is to purchase the equipment from the owner. The purchase price payable by the hirer to the owner for the equipment is the sum of any instalments due under the hire-purchase agreement and unpaid at the date of termination together with interest thereon and the discounted value of future instalments which have not yet fallen due. On payment of the purchase price by the hirer to the owner the owner is to remit to the hirer the amount of any sum which may have been received by the owner from the sub-lessees on the termination of the lease. Since it was in practice impossible to exclude the latter sum from the scope of the assignment in accordance with the provisions *625 of cl. 7, and the assignment does not attempt to do so, any sum which the sub-lessees will have paid on termination of the lease is likely to have been received by the owner.

The most likely occasion on which the hirer would wish to avail itself of its right to terminate the hire-purchase agreement voluntarily would be the premature termination of the lease by the sub-lessees. In this event, the termination sum payable by the sub-lessees would usually be greater than the purchase price payable by the hirer to the owner.

Clause 14(B) provides that in the event of the total loss or destruction of the equipment the same consequences are to follow as would follow the voluntary termination of the hire-purchase agreement by the hirer, save that the owner is to account to the hirer for the lower of the purchase price and the termination sum payable by the sub-lessees whether it has received the termination sum or not.

Clause 14(C) provides that on termination of the hire-purchase agreement by reason of the hirer's default the hirer is to 'assign absolutely to the owner' all the rights to which it is entitled under the lease without prejudice to the owner's right to recover damages from the hirer for breach of the agreement. Clause 14(D) provides that on termination of the lease by reason of the sub-lessees' default then (broadly speaking) the same consequences are to follow as if there has been a total loss.

The effect of these provisions is that, unless the termination of the hire-purchase agreement is by reason of the hirer's default, the owner is to account to the hirer for any termination sum which it may have received from the sub-lessees; and, unless the hire-purchase agreement is terminated prematurely by the hirer, the owner is to bear the risk of the sub-lessees' failure to pay the termination sum. They thus carry into effect the provisions of cl. 7 (which excludes from the assignment the amount by which the termination sum payable by the sub-lessees exceeds the purchase price payable by the hirer) and cl. 8 (which places the risk of default by the sub-lessees on the owner).

[Part II of the Schedule](#) contains the provisions for the adjustment of the hire-purchase instalments. The adjustments are to be made quarterly in arrears but paid annually at the same time as the fourth quarter's instalment would fall due for payment if it were not franked by the rental due under the lease.

The lease

It is not necessary to refer to the terms of the lease save to say that the rental payments under the lease could differ from the instalments under the hire-purchase agreement in the event of changes in the rates of annual writing down allowances or in corporation tax.

The assignment

Nor is it necessary to refer in any detail to the terms of the assignment of the benefit of the lease by Atlantic to Orion. It does not mention the purchase price of the equipment. It is expressed to be in consideration of Atlantic entering into the hire-purchase agreement and contains nothing which is inconsistent with its being an absolute assignment except a clause in the following terms:

‘It is hereby agreed that s. 93(1) of the Law of Property Act 1925 (relating to the right of consolidation) and s. 103 of the Law of Property Act 1925 (regulating the exercise of power of sale) shall not apply to *this security*.’ (Emphasis added).

References to either of those sections would be wholly out of place in an absolute assignment.

The approach of the court

The proper approach which the court adopts in order to determine the legal category into which a transaction falls is well established. The most recent case on the subject is **626 Welsh Development Agency v Export Finance Co Ltd [1992] B.C.C. 270*. The first task is to determine whether the documents are a sham intended to mask the true agreement between the parties. If so, the court must disregard the deceptive language by which the parties have attempted to conceal the true nature of the transaction into which they have entered and must attempt by extrinsic evidence to discover what the real transaction was. There is no suggestion in the present case that any of the documents was a sham. Nor is it suggested that the parties departed from what they had agreed in the documents, so that they should be treated as having by their conduct replaced it by some other agreement.

Once the documents are accepted as genuinely representing the transaction into which the parties have entered, its proper legal categorisation is a matter of construction of the documents. This does not mean that the terms which the parties have adopted are necessarily determinative. The substance of the parties' agreement must be found in the language they have used; but the categorisation of a document is determined by the legal effect which it is intended to have, and if when properly construed the effect of the document as a whole is inconsistent with the terminology which the parties have used then their ill-chosen language must yield to the substance.

Unhappily there is no single objective criterion by which it is possible to determine whether a transaction is one of sale and repurchase or security. In a well-known passage in *Re George Inglefield Ltd [1933] Ch 1* at p. 27 Romer LJ explained the essential differences between a transaction of sale and a transaction of mortgage or charge. They are threefold. (1) In a transaction of sale the vendor is not entitled to recover the property sold; in the case of a mortgage or charge the mortgagor is entitled to redeem the mortgage and recover the mortgaged property. (2) If a purchaser sells the property he has purchased, he may keep any profit he has made on the transaction; if a mortgagee does so, he must account for the profit to the mortgagor. (3) If a purchaser sells the property he has purchased and makes a loss on the transaction, he cannot recover his loss from the vendor; if a mortgagee realises the mortgaged property for less than he is owed, he may recover the balance from the mortgagor.

The difficulty is that no single one of these features may be determinative. The absence of any right in the transferor to recover the property transferred is inconsistent with the transaction being by way of security; but its existence may be inferred, and its presence is not conclusive. The transaction may take the form of a sale with an option to repurchase, and this is not to be equated with a right of redemption merely because the repurchase price is calculated by reference to the original sale price together with interest since the date of the sale. On the other hand, the presence of a right of recourse by the transferee against the transferor to recover a shortfall may be inconsistent with a sale; but it is not necessarily so, and its absence is not conclusive. A security may be without recourse. Moreover the nature of the property may be such that it is impossible or at least very unlikely that it will be realised at either a profit or loss. Many financing arrangements possess this feature. The

fact that the transferee may have to make adjustments and payments to the transferor after the debts have been got in from the debtors does not prevent the transaction from being by way of sale.

In *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* [1992] BCLC 609 Lord Wilberforce commented on the difficulty of distinguishing between a sale and a security by reference to the financial results which the transaction achieved. He said at p. 617F:

‘My Lords, the fact that the transaction consisted essentially in the provision of finance, and the similarity in result between a loan and a sale, to all of which I have drawn attention, gives to the appellants' arguments an undoubted force. It is only *627 possible, in fact, to decide whether they are correct by paying close regard to what the precise contractual arrangements between them and the respondents were.’

In that case Lord Wilberforce was able to hold that even a ‘right of redemption’ was not inconsistent with the transaction being one of sale. After taking all factors into account which were urged in favour of the transaction being by way of security, Lord Wilberforce nevertheless held that it was what it purported to be, viz: a transaction of sale.

The legal classification of a transaction is not, therefore, approached by the court in vacuo. The question is not what the transaction is but whether it is in truth what it purports to be. Unless the documents taken as a whole compel a different conclusion, the transaction which they embody should be categorised in conformity with the intention which the parties have expressed in them.

Sale or security

Counsel for Orion submitted that despite the terms of cl. 7 of the hire-purchase agreement Atlantic was left with no equity of redemption and that the assignment was accordingly incapable of taking effect as a security. He relied on cl. 8(B) by which Atlantic's obligation to pay instalments of hire was to be satisfied by the assignment of the lease rentals, and submitted that the assignment was not a security for the instalments of hire but the means of paying them. He subjected the provisions of cl. 14 of the hire-purchase agreement to a detailed analysis designed to show that there were no circumstances in which the lease rentals could provide security for any outstanding obligation of Atlantic. The judge rejected these arguments, even if well-founded, by reference to the limited recourse provisions under the interest-rate adjustment provisions. While they remained in operation, he pointed out, the instalments of hire might be more or less than the rent payable under the lease. He continued ([1994] B.C.C. 897 at p. 913):

‘If less than Atlantic was entitled to be repaid annually the amount of the difference. Its entitlement reflects its right as chargor to a surplus over the amount required to discharge its liability in the hands of Orion. [Counsel for Orion] pointed out that Atlantic is entitled to be paid the amount of a difference in its favour under the express terms of the schedule but that cannot, I think, be treated as a contractual right independent of its right as chargor.’

I do not find this reasoning persuasive. It is unsatisfactory to make the nature of the assignment depend upon the interest rate adjustment provisions. These are by way of an additional refinement which is extrinsic to the main financing arrangements and takes effect extraneously to the assignment.

If the adjustment at the end of the year results in a sum payable by Atlantic to Orion, Atlantic's obligation to make the payment is not discharged by the non-recourse provisions of cl. 8. Accordingly this obligation is in theory at least one of the obligations of Atlantic which is secured by the assignment. But, as counsel for Orion pointed out, when the sum becomes due for payment there is nothing on which it can be secured. The subject-matter of the alleged security is the rental stream

under the lease, and the obligation to pay the balance due in respect of the interest rate adjustment is an obligation to pay an additional sum over and above that comprised in the security.

The judge took the converse case, where the balance payable at the end of the year is in favour of Atlantic. He described Atlantic's entitlement to this sum as reflecting its right as chargor to a surplus over the amount required to discharge its obligation to pay the hire-purchase instalments. This seems to me to beg the very question to be decided.

In my view the interest rate provisions must be taken as a whole and are extrinsic to the assignment. The consideration for Atlantic's right to receive payment at the end of the year if interest rates have moved in its favour is its obligation to make a payment to *628 Orion if they have moved the other way. Just as the latter cannot sensibly be regarded as secured on the lease rentals, so the former cannot sensibly be regarded as reflecting a chargor's right to receive the surplus after discharging its liabilities to the chargee. It is in any case an unusual provision to find in a security. A chargor is not normally entitled, without redeeming the security, to have it valued and to be repaid the amount by which its value exceeds the amount of the liabilities currently due and secured thereon.

Nevertheless I am in full agreement with the judge's conclusion that the assignment is by way of security. In my judgment the structure of the financing arrangements and the language in which they are expressed compels this conclusion. The acquisition of the equipment by Atlantic is financed by hire-purchase, not by the sale of the rents to fall due under the lease. The principal document is the hire-purchase agreement of which Atlantic's obligation to assign the lease rentals forms an integral part. The purpose of the assignment is not to finance the purchase of the equipment but to provide the mechanism by which Orion's right to receive the instalments of hire is without recourse to Atlantic. If Atlantic is regarded as financing the acquisition of the equipment by means of the outright sale of the rents, it is difficult to see what function is performed by the hire-purchase agreement.

In analysing the transactions which the several documents carry into effect it is clearly necessary to begin with the hire-purchase agreement, not with the assignment. The assignment is expressed to be made in consideration of the hire-purchase agreement and is in fact made because cl. 7 of the hire-purchase agreement requires it. The hire-purchase agreement describes Orion as 'the owner' at a time when the assignment has not yet been made. It assumes that Orion has acquired the equipment by some transaction *dehors* the financing arrangements which it embodies.

It is in my view significant that the amount of the cost of the equipment is stated in the hire-purchase agreement and not in the assignment; that the assignment is not expressed to be made in consideration of a purchase price; that cl. 14(A) of the hire-purchase agreement gives Atlantic a right to terminate the hiring, not to repurchase the lease rentals; and that the purchase price payable by Atlantic in the event of the termination of the hire-purchase agreement is calculated by reference to the discounted value of future instalments of hire under the hire-purchase agreement and not of future rents under the lease. It is also significant that, in the event of the termination of the hire-purchase agreement by reason of the default of Atlantic, Atlantic is required to assign absolutely to Orion the very same rights which have previously been assigned to it. Whether such a provision is strictly necessary or not, it appears to envisage Atlantic retaining an interest in the lease rentals after the assignment required by cl. 7, and it is difficult to identify any interest other than a right of redemption.

It is not necessary to decide whether, if changes in corporation tax result in the amount of the rentals due under the lease exceeding the amount of the instalments of hire due under the hire-purchase agreement, Orion is entitled to keep the difference. Both parties relied on this feature of the arrangements. Counsel for Crown submitted that it was plainly not intended that Orion should keep the excess; yet there was no mechanism, other than a redemption account, by which Atlantic could recover it. Accordingly, he submitted, Atlantic must be treated as having a right to redeem, and this showed that the assignment was by way of security. Counsel for Orion, by contrast, submitted that cl. 14 provided an exhaustive code for the account which

was to take place on the termination of the arrangements. Orion, he submitted, was entitled to retain the excess; and this showed that an absolute sale of the rentals was intended. I incline to the view that cl. 14 does provide an exhaustive code for the accounting which is to take place in the event of termination of the hire-purchase agreement, and that Orion is entitled to keep the excess. Whether this is due to an oversight, however, or whether it is part of the price which *629 Atlantic agreed to pay for the non-recourse nature of the security, it is not necessary to decide. In my judgment, this singular feature of the arrangements is insufficient to displace the overall effect produced by the documents.

The structure of the transaction, in my judgment, is that of a hire-purchase agreement coupled with a non-recourse charge of the lease rentals to secure the payment of the instalments of hire. That this is the nature of the transaction is confirmed by the language of the documents. Clause 7 of the hire-purchase agreement is unequivocal in requiring an assignment by way of security; cl. 14(A) assumes that the assignment is not an absolute assignment; and the terms of the assignment itself are consistent with the same assumption. Atlantic expressly undertakes an obligation to pay the hire instalments, even if the obligation is satisfied by the assignment; the assignment purports to be security for payment of the instalments as well as the means of paying them. There is nothing in the documentation which is inconsistent with the intention of the parties being to create a charge, and I would construe the documentation in conformity with that intention.

I would dismiss Orion's appeal from the decision of the judge that the assignment of the lease rentals was registrable as a charge of Atlantic's book debts and, not having been registered, is void against the administrative receivers and liquidators of Atlantic. It thus becomes necessary to hear argument on the question whether this affords Crown a defence to Orion's claim to rent.

Otton LJ: I have had the opportunity to assimilate the analysis and reasoning of Millett LJ. I agree wholly with his approach and conclusion.

Central to the case for the appellant was the proposition that it was the intention of the three parties, Orion (funder), Atlantic (lessor) and Crown (lessee), that once the contractual edifice was in place Atlantic would drop out of the picture. I am unable to accept that proposition either from commercial reality or from what I regard to be the true construction of the documents under consideration.

Atlantic were at the material time the largest leasers of computer equipment in the world. Orion was only one of the funders Atlantic used. Crown was an Atlantic customer. Due to its dominant position in the particular market Atlantic could exploit the equity in the lease on redemption. The predominant contractual relationship was the lease. The funding of the project through a hire purchase agreement was secondary. Far from dropping out Atlantic retained a keen commercial interest in whether the lease ran the full seven years or for a shorter period.

Computer equipment, by its very nature, is obsolescent on installation and Atlantic enabled the customer to trade in the equipment and replace it with the latest state-of-the-art equipment. The seven-year lease did not permit the lessee to do this without heavy financial penalty.

The management agreement gave the customer the opportunity to trade in during the currency of the lease; Atlantic undertook to settle the lessee's obligations provided that the replacement equipment was again leased through Atlantic.

Clause 1 provided:

‘Atlantic will arrange for the lease agreement to be terminated by the lessee after a period of five years has elapsed at no penalty subject to the following terms and conditions–

...

These terms and conditions having been duly observed, Atlantic hereby undertakes to settle in full all further charges due from the lessee to the lessor in respect of the lease agreement.’(This was known as the ‘WALK’ option.)

and Clause 2 provided: ***630**

‘At the request of the lessee, Atlantic will arrange for the machines leased – to be replaced by any alternative IBM data processing machines of equivalent or greater capital value after a period of three years has elapsed at no penalty subject to all the terms and conditions ...

These terms and conditions having been duly observed Atlantic hereby undertakes to settle in full all charges due from the lessee to the lessor arising out of the said replacement provided always that the alternative IBM data processing machines are leased through Atlantic.’ (This was known as the ‘FLEX’ or ‘SWOP’ option.)

Thus far from dropping out of the picture Atlantic ensured that they were pivotal to the next replacement transaction. The customer was tied to Atlantic. Once the customer had entered into the new lease Atlantic would then look for a favourable funder.

Against this background it is inherently unlikely that once Atlantic granted such options and were prepared to take back the lease they would have entered into an outright sale (i.e. an absolute assignment) of the lease to Orion.

It is common ground that the hire-purchase agreement is not a sham. Clause 7 speaks for itself:

‘The hirer (Atlantic), as security for its obligations hereunder, shall assign to the owner (Orion) under the terms of a deed of assignment all moneys now or hereafter to become payable to the hirer under the lease to the intent that they be charged with the payment of all moneys now or hereafter owing to the owner under this agreement except that such a security and assignment will not encumber or extend to [excepted payments]’.

The critical phrases are ‘as security for its obligations hereunder’, ‘they be charged’, ‘such security’ and ‘encumber’. The use of these phrases in this context is in my judgment only consistent with an assignment by way of security and inconsistent with an absolute assignment.

That construction is not, to my mind, undermined by any of the other critical clauses in the hire-purchase contract. On the contrary, they tend to emphasis the continuing interest of Atlantic.

The obligations of Atlantic secured by the assignment are set out in cl. 8 and [Sch. 1](#) , namely, to pay the instalments or adjusted instalments. The amount of the instalments matches what is due from Crown to Atlantic under the lease agreement.

However, the instalments payable under the hire-purchase contract may turn out to be greater or less than the lease rentals because of variations in rates of (i) interest, and (ii) capital allowances, writing down allowances and corporation tax.

In the event of movements in interest rates the instalments due to Orion are subject to adjustment whereas the lease rentals due from Crown are not. The amount due from Atlantic to Orion may be more or less than what is due from Crown to Atlantic. If more is due, Atlantic is liable to pay the difference to Orion. If less is due, Atlantic is entitled to the difference from Orion subject to Orion's security. Thus Atlantic plainly has a continuing interest in the lease rentals.

Similarly, under cl. 23 of the lease agreement payments due from Crown to Atlantic are subject to adjustment in order to maintain 'the net after tax return to the lessor [Atlantic] in respect of its expenditure on the machines.' This adjustment is triggered by changes in the rates of capital allowances, writing down allowances or corporation tax. There is no equivalent provision for adjustment under the hire-purchase contract. Accordingly, if the payments due from Crown are increased, Atlantic is entitled to the difference. The purpose of cl. 23 is to preserve *Atlantic's* net after tax return. There is thus a potential benefit to Atlantic which has nothing to do with Orion. This arrangement militates against an absolute assignment to Orion.

**631*

Clause 14(A) of the HP contract entitles Atlantic on payment of the arrears of hire-purchase instalments and future instalments (discounted) to discharge its outstanding obligations under the hire-purchase contract and in return, to receive title to the computer equipment and the right to payment of any termination sum from Crown payable under the lease agreement. I accept Mr Sher's submission that this right to redeem represents Atlantic's equity of redemption and that it would be nugatory if all Atlantic's rights under the lease agreement have been assigned absolutely to Orion. On redemption by Atlantic any right to receive the lease rentals must re-vest in Atlantic.

It follows that I too would find for the respondents on the construction issue.

Sir Stephen Brown P: I have had the opportunity of reading the judgments of Millett and Otton L JJ in draft. I agree that for the reasons which Millett LJ gives, Orion's appeal from the decision of the judge that the assignment of the lease rentals was registrable as a charge of Atlantic's book debts should be dismissed.

It will therefore be necessary to hear argument on the further issue identified by Millett LJ.

JUDGMENT

(Delivered 29 July 1996)

Millett LJ: This is the second stage of the appeal by Orion Finance Ltd ('Orion') from the dismissal of its action against Crown Financial Management Ltd ('Crown'). The facts are stated in the judgment of Vinelott J ([1994] B.C.C. 897) and in the judgments in this court at the earlier stage of the appeal to which reference may be made if necessary. For present purposes they can be briefly summarised as follows.

The action is for rent due under a lease of computer equipment made between Atlantic Computer Systems plc ('Atlantic') and Crown and assigned by Atlantic to Orion. The lease was for a period of seven years from March 1986. Shortly after the assignment had taken place it was agreed between Atlantic and Crown that Crown should have the right (the 'walk option') to terminate the lease after five years. The agreement provided that if Crown exercised the walk option Atlantic would make

arrangements for the lease to be terminated without penalty at the end of the fifth year and would settle in full all further charges due from Crown to the lessor in respect of the lease.

In February 1990 Crown exercised the walk option. Two months later Atlantic went into administration. Crown continued to pay the rent to Orion pursuant to a direction by the administrators to that effect. The fifth year of the lease ended in March 1991, and Crown refused to pay any further rent under the lease. Two years later Atlantic was put into liquidation. Orion brings the present Action against Crown to recover rent due during the last two years of the lease.

Vinelott J held that the walk option was separate from the lease and was not binding on Orion. There is no appeal from this part of his decision. But he also held that the assignment to Orion constituted a charge over book debts of Atlantic which was registrable under [s. 395 of the Companies Act 1985](#) and, not having been registered, was void against the administrators and liquidators of Atlantic. He held further that this provided a complete defence to Orion's claim to rent and accordingly dismissed the action.

Two questions thus arose on the appeal: (1) whether the assignment of the rent to Orion was by way of charge; and if so (2) whether the invalidity of the assignment against the administrators and liquidators of Atlantic affords Crown a defence to Orion's claim. We heard argument on the first question last December and dismissed Orion's appeal in respect of it. We now have to deal with the second question.

So far as material [s. 395\(1\) of the Companies Act](#) provides: ***632**

‘Subject to the provisions of this Chapter, a charge created by a company registered in England and Wales and being a charge to which this section applies is, *so far as any security on the company's property or undertaking* is conferred by the charge, void *against the liquidator or administrator and any creditor of the company ...*’ (my emphasis).

It is common ground that the charge was one to which the section applies.

Mr Martin QC, who appeared for Orion, submitted that the effect of the section is to avoid the assignment as between the administrators and liquidators of Atlantic but not as between Crown and Orion. He relied on a short passage in the judgment of Lush J in *Saunderson & Co (in liq.) v Clarke (1913) 29 TLR 579* where he is recorded as saying:

‘He thought that s. 93 [the predecessor of s. 395] did nothing more than avoid the security as between the parties to the transaction.’

The judge dealt with Mr Martin's submission as follows ([\[1994\] B.C.C. 897](#) at pp. 913H–914A):

‘... the short answer to Mr Martin's submission is that s. 395 clearly avoids the assignment as between the administrators or liquidators of Atlantic and Orion. It follows that notice of the assignment would not afford any defence to Crown if sued by the administrators in respect of a period prior to the exercise of the walk option. So, if Mr Martin's submission were well founded, Crown might be faced by two claims for the same rent. It cannot, I think, make any difference that the result of the avoidance of the assignment as between Atlantic and Orion was to put Crown in a position, when the walk option became exercisable, to terminate the lease and so prevent Orion from recovering rent which could never have been an asset of Atlantic ...’

Before us Mr Martin conceded that Orion had no title to the rent which accrued due after the date of the administration order and before the end of the fifth year of the term. The assignment was void as against the administrators, and accordingly they were the persons entitled to receive the rent. Orion was entitled to it only because the administrators directed Crown to pay it to Orion. But, Mr Martin insisted, the position was different in respect of the rent during the last two years of the term. The walk option did not bind Orion, and accordingly Orion was entitled to the rent subject only to the operation of [s. 395](#). Atlantic, on the other hand, was bound by the walk option, and accordingly the administrators and liquidators were not entitled to the rent and had no interest in enforcing the section. [Section 395](#), Mr Martin submitted, was enacted for the benefit of the insolvent estate and the unsecured creditors of the chargor. It should be given a purposive construction and not one the only effect of which is to benefit a third party such as Crown.

Attractively as these arguments here put, I am not persuaded by them. The fact that s. 395 may operate for the benefit of a lessee and not the insolvent estate is curious, at least at first sight; but this is the result, not of the effect of the section in avoiding the assignment, but of the effect of the walk option once the assignment had been avoided. It would be far more curious if Orion, which *ex concessis* would not have been entitled to any rent at all if Crown had not exercised the walk option, should become entitled to the last two years' rent when it did. That would indeed be Alice in Wonderland.

In my judgment the concession, which was inevitable, that the administrators and liquidators were entitled to the rent before the expiry of the fifth year of the term, is fatal to Orion's case. There is no material distinction between the rent due before and after that date. In an attempt to persuade us that there is, Mr Martin put forward three arguments called respectively 'the property argument', 'the priority argument' and 'the estoppel argument.' I shall deal with each in turn.

*633

The property argument

This argument was based on the fact that s. 395 avoids a charge only so far as it confers a security on property of the company. The section does not operate to avoid the charge for all purposes or against the whole world. The charge remains valid against the company itself, and the personal liability of the company is provable as an unsecured debt. Accordingly, Mr Martin submitted, it is necessary to consider the effect of the section at the date of the commencement of the insolvency. At that date Crown had already given notice exercising the walk option. The effect of this, he submitted, is that Atlantic thereafter had no right to recover the last two years' rentals. Accordingly, it was said, that right cannot be regarded as property of Atlantic.

In so far as the submission took the commencement of the insolvency as the time at which the subject-matter of the charge is to be ascertained I do not accept it. In my judgment it is clear that the relevant time for this purpose is when the security is created: see *Paul & Frank Ltd v Discount Bank (Overseas) Ltd [1967] Ch 348* at p. 362. Of course, if the subject-matter of the charge has ceased to belong to the company before insolvency supervenes, the section will cease to have any operation, but that is a different matter. In the present case the subject-matter of the charge was a seven-year lease. At the date of the charge the benefit of the lease was an asset of Atlantic. The fact that in Atlantic's hands the lease was subject to the walk option did not prevent it from being an asset of Atlantic.

In my judgment, however, the argument fails at the last stage. It is not correct to say that the right to receive the last two years' rent did not form part of the property of Atlantic. The right to receive those rents was a right which belonged to Atlantic and which was transferred by Atlantic to Orion by an assignment which statute afterwards made void. Thereafter it fell to be dealt with as an asset of the insolvent estate. As Mr Sher QC, who appeared for Crown pointed out, the whole foundation of Orion's case is that the lease was assigned to Orion free from the walk option so that the cross-claims of Crown and Atlantic arising out of the exercise of the walk option would not affect Orion's entitlement to the rent due under the lease for the full term of seven years. To argue at the same time that the right to receive the rent for the full seven years was not part of the property or undertaking of Atlantic is inconsistent with the basis of Orion's claim.

It is essential to Orion's claim, not only that the right to receive the last two years' rent was assigned to Orion, but that the exercise of the walk option did not determine the lease, for if it did Orion would not be entitled to rent thereafter. In fact it did not determine the lease but merely gave Crown the right to demand that Atlantic pay the last two years' rent and to prove in the liquidation if Atlantic failed to do so. Atlantic's right to the rent and Crown's right to damages for breach of contract, which were equal and opposite, fell to be set off against each other. As Mr Martin accepted, the only reason why the liquidators did not demand payment of the rent is that they would be met by a cross-claim in the same amount. But Crown's cross-claim is premised on the avoidance of the assignment to Orion and its own continuing liability to pay the rent to Atlantic. As Mr Sher pointed out in argument, Mr Martin's assertion by Orion that the liquidators' claim would be met by a cross-claim is destructive of his argument.

The matter can be put another way. The substance of the arrangements between Atlantic and Crown and between Atlantic and Orion was that Crown should have the right to be relieved of liability for the last two years' rent but that Orion should have the security of the rent for the full seven years. Crown's right was in effect subject to Orion's security. That security being avoided, there is nothing to prevent full effect being given to Crown's right.

*634

The priority argument

This argument proceeded on the basis that s. 395 is concerned with questions of priority as between those asserting claims to the charged asset rather than with the validity of the charge per se. Accordingly, Mr Martin submitted, the section merely affected the priority of Orion's right to receive the last two years' rents as against any competing claim to the same rents by the administrators or liquidators of Atlantic. They need not be considered, he said, because they are not asserting and have no interest in asserting any claim to the rents in question. Given the limited effect of the section, the argument proceeded, it merely produced a statutory reassignment to Atlantic. Unless and until the liquidators demanded payment, Crown remained liable to pay Orion.

There are several fallacies in this argument. In the first place, even though the section may be concerned with priorities, the way in which it affects them is by avoiding the assignment, i.e. Orion's title. In the next place, the section does not produce a statutory reassignment, though if it did it would plainly deprive the assignee of title to the property assigned to it. The section merely enables the liquidator to deal with the subject-matter of the unregistered charge as an asset in the liquidation. But the real fallacy of the argument is that it assumes that the rents have not already been dealt with in the liquidation.

When it exercised the walk option Crown became entitled to call upon Atlantic to discharge its liability to pay the rent due in respect of the last two years of the lease. In those cases where the assignment to Orion was duly registered, Orion was entitled to the rent, and Crown was left to prove in the liquidation for damages for breach of Atlantic's obligation to pay the rent. Where the assignment to Orion was not registered, it was void as against the administrators and liquidators of Atlantic, with the result that the rent became payable to them and not to Orion. This is conceded as regards the rent due before the end of the fifth year of the term; but it is equally true of the rent due during the last two years of the term with this difference, that the liquidators' claim to the latter rent is extinguished by Crown's right to set off its own cross-claim against it.

Insolvency set-off is immediate and self-executing: see *Stein v Blake* [1995] B.C.C. 543; [1996] 1 AC 243. In my judgment, Atlantic must be taken to have received the rent for the last two years, albeit by set-off and not by payment. Not only has Orion no title to the rent which it claims, the right to which formed part of the insolvent estate, but Crown's liability to pay such rent has been satisfied by way of set-off in the liquidation.

The estoppel argument

Mr Martin's third argument was based on an alleged estoppel. Mr Sher objected to the point being entertained, since it was not pleaded or argued below. We heard brief argument, from which it appeared that Mr Martin wished to rely exclusively on the terms of the letter by which Crown acknowledged receipt of notice of the assignment of the lease to Orion. The letter was dated after the last date for registration and addressed to Atlantic, and there was no evidence that it came to the attention of Orion or that Orion relied on it in any way. But quite apart from these minor difficulties, the terms of the letter itself make the estoppel argument hopeless.

By the letter Crown confirmed that it had been informed of the assignment of the lease to Orion and that it agreed to the terms stated in the letter from Atlantic under reply. It may be possible to spell out of this correspondence acknowledgements by

Crown that the lease was a valid lease for a term of seven years and that the lease had been validly assigned to Orion. But all these facts were true. The lease was a valid lease for seven years; Crown does not rely on the walk option as against Orion. Moreover the assignment was a valid assignment at the date of the letter, and even today it remains a valid assignment as against Atlantic. It passed the right to receive the rent to Orion; the failure *635 to register it caused the right to receive the rent to be treated as an asset in the liquidation of Atlantic, but that is all. It is quite impossible to spell out of the letter any representation by Crown that the assignment had been registered or that it would be binding on the administrators and liquidators of Atlantic in the event of its insolvency. It is to be observed that if the estoppel argument prevailed, it would have entitled Orion to the rent before as well as after the end of the fifth year of the term.

Conclusion

For the reasons which I have stated, I am of the opinion that Orion has no title to the rent which it claims, and the appeal must be dismissed.

Swinton Thomas LJ: I agree.

Pill LJ: I also agree.

(Appeal dismissed) *636

Exhibit 8

***1913 School Facility Management Ltd and others v Governing Body of Christ the King College and another**



No Substantial Judicial Treatment

Court

Queen's Bench Division (Commercial Court)

Judgment Date

7 May 2020

Report Citation

[2020] EWHC 1118 (Comm)

[2020] P.T.S.R. 1913



Queen's Bench Division

Foxton J

2020 March 2-5, 9-12; May 7

Local government—Powers—Financial transactions—Maintained school entering into hire contract for construction and hire of new sixth form building—School and council providing letter to counterparty pre-contract as to school's capacity to enter into contract—School failing to pay annual instalment under contract when due—Counterparties bringing claim against school and council under contract, in misrepresentation or misstatement, and in unjust enrichment—School counterclaiming in unjust enrichment—Whether school council's agent—Whether agency established by reason of legislation governing funding relationship between maintained schools and councils—Whether contract “borrowing” subject to Secretary of State's consent or contrary to council's scheme on financing of maintained schools and thereby ultra vires school—Whether contract void—Whether claim in misrepresentation or misstatement barred by ultra vires finding—Whether counterparty able to defend counterclaim in unjust enrichment on basis of anticipatory change of position— School Standards Framework Act 1998 (c 31) (as amended by Education and Inspections Act 2006 (c 40), s 57, Sch 5, para 3 and Local Education Authorities and Children's Services Authorities (Integration of Functions) Order 2010 (SI 2010/1158)), ss 48, 49(5)(6) — Education Act 2002 (c 32), s 19(6), Sch 1, para 3(3)(a) (4)(a) — School and Early Years Finance (England) Regulations 2012 (SI 2012/2991), reg 22

The college, a voluntary aided school maintained by the council, obtained permission from the council to expand its age range and open a sixth form. It subsequently entered into a hire contract for the construction and hire of a building and associated equipment to accommodate the additional numbers. The building was provided and assembled by B, which subsequently sold the building to the second claimant, which in turn entered into the contract to lease the building to the college. Subsequent assignments led to the first claimant and then the third claimant obtaining the right to payments made by the college under the contract. The college failed to pay an annual instalment under the contract when it fell due, and the claimants commenced proceedings against the governing body of the college and the council (together “the defendants”) for debt and damages under the contract. The claimants contended that the contract was binding on both the college and the council as the college's principal, agency being established as a matter of fact and/or by application of [regulation 22 of the School and Early Years Finance \(England\) Regulations 2012](#)¹, containing the council's duty to fund maintained schools in its area, and/or by **1914* application of [section 49\(5\) and \(6\) of the School Standards Framework Act 1998](#)², which provided for local authorities to provide maintained schools with a delegated budget and provided that such a budget was spent as the council's agent except in certain defined circumstances. The defendants defended the claim, asserting that the contract was ultra vires the college with the result that the claim had to fail. The grounds on which they alleged that the contract was ultra vires were, inter alia, that it was a “finance lease” amounting to “borrowing” and thus, in so far as the Secretary of State's consent to such borrowing had not been obtained, outside the college's capacity by reason of [paragraph 3\(3\)\(a\) and \(4\)\(a\) of Schedule 1 to the Education Act](#)

2002³; or that, by reason of [section 48](#) of the 1998 Act, the council was required to issue a scheme dealing with such matters connected with the financing of maintained schools, and the contract did not comply with the terms of the scheme so issued. In the alternative, the claimants advanced a claim in misrepresentation and/or misstatement, relying on pre-contractual letters from the college and the council to the effect that the college had capacity to enter into the contract and contending that, but for the representation, they would have entered into an equivalent contract with a counterparty who did have capacity. In the further alternative, the claimants advanced a claim in unjust enrichment. The defendants defended those further claims and the college also brought a counterclaim in unjust enrichment against the first claimant, which the first claimant defended on the basis of change of position, it having paid for the acquisition and construction of the building, and despite some of the payments sought to be recovered having been made after the last amount which the first claimant had paid to B.

On the claims and counterclaim—

Held, dismissing the claims in contract against the college and the council, (1) that since the contract clearly identified the parties to the contract as B and the college, and made no reference to the council, and the contemporaneous documents all referred to the college as B's counterparty, as a matter of fact the college was not the council's agent; that an agency was not implicit in the local authority's duty to fund maintained schools under [regulation 22\(1\) of the School and Early Years Finance \(England\) Regulations 2012](#), especially in circumstances where the contracting college incurred expenditure relating to the provision of sixth form education which the council was not legally obliged to, and did not, fund; that [section 49\(5\) and \(6\) of the School Standards Framework Act 1998](#) did not operate so as to render the local authority the principal under any contract into which the maintained school entered under which it would be liable to pay money; and that, accordingly, if the contract was valid the putative contracting party was the college and not the council and the claim against the council failed for that reason (post, paras 84–85, 86–87, 92, 93, 95, 97, 100–101, 102, 103, 105, 106, 108, 250).

Dictum of Zacaroli J in *Brent London Borough Council v Davies [2018] EWHC 2214 (Ch)* at [344] applied.

Dictum of Underhill J in *Coventry City Council v Special Educational Needs and Disability Tribunal [2008] ELR 1*, para 13 not applied.

(2) That a scheme issued by a council pursuant to [section 48 of the School Standards Framework Act 1998](#) generally only imposed obligations on the maintained school as to how it should conduct itself and did not define the legal powers of the school, except that a particular provision within a scheme could impose a limit on the school's power to contract if that provision made it sufficiently clear that compliance with it constituted a limitation on the extent of the school's power; that the obligations in the council's scheme regulated only as between the college **1915* and the council how the college should exercise its powers and did not constitute a legal limit on the college's vires; that, however, [paragraph 3\(4\)\(a\) of Schedule 1 to the Education Act 2002](#) imposed a statutory condition precedent to the power of a governing body to borrow money, namely obtaining the consent of the Secretary of State, which limited the governing body's power to borrow rather than simply imposing a requirement as to the manner of its exercise; that that requirement applied both when money was borrowed and/or when security was granted in respect of such borrowing, and not only when both things were done together; that “borrowing” for the purposes of paragraph 3(4)(a) could encompass a hire contract, and what constituted “borrowing” turned not on how the transaction was structured or labelled but involved consideration of the economic substance of the transaction; that since the established accounting tests for identifying a finance lease involved an analysis as a matter of substance and not of form, if they identified the contract as a finance lease, it would therefore constitute “borrowing” so as to engage paragraph 3(3)(a) and 4(a); that, applying the applicable accounting standards, the contract was a finance lease and therefore involved “borrowing”; and that, since the contract was entered into without the permission of the Secretary of State, the contract was accordingly ultra vires the college and void, and the claims against both the college and the council failed for that reason (post, paras 172–173, 174–175, 176–181, 249, 250, 271, 278, 281, 284, 287, 289, 292, 507).

Dicta of Harman J in *Rhyl Urban District Council v Rhyl Amusements Ltd* [1959] 1 WLR 465 , 473–474, 475 and of Neill LJ in *Crédit Suisse v Allerdale Borough Council* [1997] QB 306 , 317, 332–333, CA applied.

Dismissing the claim in misrepresentation and/or misstatement but allowing the claim in unjust enrichment against the college and the council, (3) that the rule that a public body could not make a legally enforceable promise that it had the capacity which it in fact lacked, or could not be held by a doctrine of estoppel to a representation it had made that it had the capacity which it lacked, was not confined to cases where the claimant sought to place itself in the same position as if the defendant had had vires, but could also extend to cases where the claimant sought only to assert a reliance interest; that a distinction between a representation by the public body that the transaction was valid and a representation that it had or would obtain power to enter into a transaction was also not on its own decisive; that, given that the substance of the claimants' case was that they had been led to believe that they could and had entered into a valid contract with the college and the representation in question was based on a letter from the college shortly before the contract was signed, and given further that the loss sought by the claimants was one which protected their expectation interest, the finding of ultra vires in relation to the contract accordingly barred any misrepresentation or misstatement claim against the college but not against the council, which was not a party to the contract and had not established that it would have been outside its own capacity to enter into the contract; that, however, since the claimants had not established that, but for the contract, they would have entered into a contract with a third party on essentially similar terms, and further since the defendants' representations were only expressions of opinion and were true when made and there was no reliance as a matter of fact on the statements, any misrepresentation or misstatement claim failed; but that the college and the council had been unjustly enriched at the expense of the first claimant, which was accordingly entitled to recover in unjust enrichment for the period subsequent to the missed annual instalment payment (post, paras 362, 363, 364, 365, 366, 368, 369, 371–373, 385–386, 387, 398–400, 407–412, 423, 431, 433–434, 440, 507).

Dicta of Harman J in *Rhyl Urban District Council v Rhyl Amusements Ltd* [1959] 1 WLR 465 , 473 and of Clarke J in *South Tyneside Metropolitan Borough Council v Svenska International plc* [1995] 1 All ER 545 , 565 applied. *1916

Salmon Harvester Properties Ltd v Metropolitan Police Authority [2004] EWHC 1159 (QB) considered.

Dismissing the college's counterclaim, (4) that, on the facts, the college was entitled to bring an unjust enrichment claim in respect of certain of the invoices it impugned; that, however, the defence of change of position to a claim brought by a public body to recover monies paid out under an ultra vires contract was available even where the change of position occurred before rather than after the receipt in question; and that that defence being established on the facts and there being no surviving asset to defeat that defence, the counterclaim failed (post, paras 453, 468–469, 475, 478, 481–482, 486, 493–494, 499, 507).

Dicta of the Privy Council in *Dextra Bank and Trust Co Ltd v Bank of Jamaica* [2002] 1 All ER (Comm) 193 , para 38, PC and of Cranston J in *Charles Terence Estates Ltd v Cornwall Council* [2012] PTSR 790 , para 98 applied.

Dictum of Clarke J in *South Tyneside Metropolitan Borough Council v Svenska International plc* [1995] 1 All ER 545 , 565 not applied.

Per curiam . If a public body lacks statutory power to enter into a contract of a particular kind, it does not have contractual capacity to do so as a matter of private law. However, where a public body has capacity to enter into a contract of a particular kind but the way in which it takes the decision to do so can be impugned on public law grounds, the nullity, as a matter of public law, of its decision to contract does not, without more, equate to a lack of contracting capacity as a matter of private law. Public law unlawfulness provides a defence to a private law claim in contract only when the facts which give rise to

that public law unlawfulness also give rise to a private law defence. Relief is discretionary and can be upheld on various grounds intended to avoid injustice to the defendant or third parties, such as if the contract was entered into with a person acting in good faith who would be prejudiced by the declaration of invalidity, particularly where there was delay in bringing the challenge. Accordingly, a decision by a public body to enter into a contract which it did not have power to conclude gives rise to a private law defence of lack of contracting capacity; but if the public body had power to enter into contracts of the relevant type but is alleged to have acted unlawfully in reaching its decision to contract, the consequence of such public law unlawfulness in private law depends both on the nature of the unlawfulness and on whether the counterparty had notice of the relevant breach of public law duty (post, paras 150, 153–155, 159, 162).

Dicta of Hobhouse LJ in *Crédit Suisse v Allerdale Borough Council* [1997] *QB* 306, 350E–G, CA and of Maurice Kay LJ in *Charles Terence Estates Ltd v Cornwall Council* [2013] *PTSR* 175, para 37, CA applied.

R (WL (Congo)) v Secretary of State for the Home Department [2012] *1 AC* 245, SC(E) considered.

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***1917** *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] *CLC* 518
Bedfordshire County Council v Fitzpatrick Contractors Ltd [2001] *LGR* 397; [2001] *BLR* 226
Benedetti v Sawiris [2013] *UKSC* 50; [2014] *AC* 938; [2013] *3 WLR* 351; [2013] *4 All ER* 253; [2013] *2 All ER (Comm)* 801, SC(E)
Benzline Auto Pte Ltd v Supercars Lorinser Pte Ltd [2018] *SGCA* 2; [2018] *1 SLR* 239, Singapore CA
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Bristol and West Building Society v Mothew [1998] *Ch* 1; [1997] *2 WLR* 436; [1996] *4 All ER* 698, CA
Bromley London Borough Council v Greater London Council [1983] *1 AC* 768; [1982] *2 WLR* 62; [1982] *1 All ER* 129; *80 LGR* 1, HL(E)
Calder Gravel Ltd v Kirklees Metropolitan Borough Council (1989) *60 P & CR* 322
Campbell Discount Co Ltd v Bridge [1962] *AC* 600; [1962] *2 WLR* 439; [1962] *1 All ER* 385, HL(E)
Caparo Industries plc v Dickman [1990] *2 AC* 605; [1990] *2 WLR* 358; [1990] *1 All ER* 568, HL(E)
Cavendish Square Holdings BV v Makdessi [2015] *UKSC* 67; [2016] *AC* 1172; [2015] *3 WLR* 1373; [2016] *2 All ER* 519; [2016] *2 All ER (Comm)* 1, SC(E)
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Commerzbank AG v Price-Jones [2003] *EWCA Civ* 1663, CA
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Hazell v Hammersmith and Fulham London Borough Council [1992] 2 AC 1; [1991] 2 WLR 372; [1991] 1 All ER 545; 89 LGR 271, HL(E)
Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465; [1963] 3 WLR 101; [1963] 2 All ER 575, HL(E)
Hillsdown Holdings plc v Pensions Ombudsman [1997] 1 All ER 862
*Hinckley and Bosworth Borough Council v Shaw [2000] LGR 9 *1918*
Hoffmann-la Roche (F) & Co AG v Secretary of State for Trade and Industry [1975] AC 295; [1974] 3 WLR 104; [1974] 2 All ER 1128, HL(E)
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Howell v Falmouth Boat Construction Co Ltd [1951] AC 837; [1951] 2 All ER 278, HL(E)
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Janred Properties Ltd v Ente Nazionale Italiano per il Turismo (unreported) 14 July 1983, CA
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London & South Eastern Railway Ltd v British Transport Police Authority [2009] EWHC 460 (Admin); [2009] Po LR 157
MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2018] UKSC 24; [2019] AC 119; [2018] 2 WLR 1603; [2018] 4 All ER 21; [2018] 2 All ER (Comm) 961, SC(E)
Macmillan Inc v Bishopsgate Investment Trust plc (No 3) [1995] 1 WLR 978; [1995] 3 All ER 747
McNaughton (James) Paper Group Ltd v Hicks Anderson & Co [1991] 2 QB 113; [1991] 2 WLR 641; [1991] 1 All ER 134, CA
NRAM Ltd (formerly NRAM plc) v Steel [2018] UKSC 13; [2018] 1 WLR 1190; [2018] 3 All ER 81, SC(Sc)
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R v Inland Revenue Comrs, Ex p National Federation of Self-Employed and Small Businesses Ltd [1982] AC 617; [1981] 2 WLR 722; [1981] 2 All ER 93, HL(E)
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Royal British Bank v Turquand (1855) 5 E & B 248
Saba Yachts Ltd v Fish Pacific Ltd [2006] NZHC 1452; 3 NZCCLR 963
Salmon Harvester Properties Ltd v Metropolitan Police Authority [2004] EWHC 1159 (QB)
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Wandsworth London Borough Council v Winder [1985] AC 461; [1984] 3 WLR 1254; [1984] 3 All ER 976; 83 LGR 143 , HL(E)
Zurich Insurance Co plc v Hayward [2016] UKSC 48; [2017] AC 142; [2016] 3 WLR 637; [2016] 4 All ER 628; [2016] All ER (Comm) 755 , SC(E)

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Bitumen Invest AS v Richmond Mercantile Ltd FZC [2016] EWHC 2957 (Comm); [2017] 1 Lloyd's Rep 219
Bolam v Friern Hospital Management Committee [1957] 1 WLR 582; [1957] 2 All ER 118
Bristol Airport plc v Powdrill [1990] Ch 744; [1990] 2 WLR 1362; [1990] 2 All ER 493 , CA
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Edgington v Fitzmaurice (1885) 29 Ch D 459 , CA
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HSH Nordbank AG v Intesa Sanpaolo SpA [2014] EWHC 142 (Comm)
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R v Hull University Visitor, Ex p Page [1993] AC 682; [1992] 3 WLR 1112; [1993] ICR 114; [1993] 1 All ER 97 , HL(E)
R v Parliamentary Comr for Administration, Ex p Balchin [1998] 1 PLR 1

R (Cart) v Upper Tribunal (Public Law Project intervening) [2009] EWHC 3052 (Admin); [2010] PTSR 824; [2011] QB 120; [2010] 2 WLR 1012; [2010] 1 All ER 908 , DC
R (Edison First Power Ltd) v Central Valuation Officer [2003] UKHL 20; [2003] 4 All ER 209 , HL(E)
R (Jackson) v Attorney General [2005] UKHL 56; [2006] 1 AC 262; [2005] 3 WLR 733; [2005] 4 All ER 1253 , HL(E)
R (Miller) v Prime Minister (Lord Advocate intervening) [2019] UKSC 41; [2020] AC 373; [2019] 3 WLR 589; [2019] 4 All ER 299 , SC(E & Sc)
R (Privacy International) v Investigatory Powers Tribunal [2019] UKSC 22; [2020] AC 491; [2019] 2 WLR 1219; [2019] 4 All ER 1 , SC(E)
R (Shropshire and Wrekin Fire Authority) v Secretary of State for the Home Department [2019] EWHC 1967 (Admin); [2019] PTSR 2052
Racal Communications Ltd, In re [1981] AC 374; [1980] 3 WLR 181; [1980] 2 All ER 634 , HL(E)
Rashdall v Ford (1866) LR 2 Eq 750
Resolute Maritime Inc v Nippon Kaiji Kyokai [1983] 1 WLR 857; [1983] 2 All ER 1; [1983] 1 Lloyd's Rep 431
Smith v Land and House Property Corpn (1884) 28 Ch D 7 , CA
Swynson Ltd v Lowick Rose llp (formerly Hurst Morrison Thomson llp) [2017] UKSC 32; [2018] AC 313; [2017] 2 WLR 1161; [2017] 3 All ER 785 , SC(E)
Wallersteiner v Moir (No 2) [1975] QB 373; [1975] 2 WLR 389; [1975] 1 All ER 849 , CA
Westdeutsche Landesbank Girozentrale v Islington London Borough Council [1994] 1 WLR 938; [1994] 4 All ER 890; 92 LGR 405, CA; [1996] AC 669; [1996] 2 WLR 802; [1996] 2 All ER 961; 95 LGR 1 , HL(E)
Wisniewski v Central Manchester Health Authority [1998] PIQR P324 , CA
Wooldridge v Sumner [1963] 2 QB 43; [1962] 3 WLR 616; [1962] 2 All ER 978 , CA
X (Minors) v Bedfordshire County Council [1995] 2 AC 633; [1995] 3 WLR 152; [1995] 3 All ER 353; 94 LGR 313 , HL(E)
Yarmouth v France (1887) LR 19 QBD 647 , DC

CLAIM and COUNTERCLAIM

On 30 April 2013, the first defendant, the Governing Body of Christ the King College (“the college”), entered into a hire contract with the second *1921 claimant, BOS Hire Ltd, for the construction and hire of a modular building and associated equipment over a 15-year period, which building was to house a sixth form at the college, the request to expand the age range of the college having been approved by the second defendant, the Isle of Wight Council (“the council”). By assignments dated 5 June and 4 July 2013, the first claimant, School Facility Management Ltd, and then the third claimant, GCP Asset Finance 1 Ltd, obtained the right to payments made by the college under the contract. On 5 September 2017, the college failed to pay the annual instalment under the contract then falling due.

By a claim form issued on 8 November 2018, the first claimant brought claims for debt and damages under the contract against the college and the council. The second and third claimants were added as claimants by later amendments. The defendants alleged that the contract was beyond the capacity of the college and outside the authority of those who signed the contract, and that the council was not party to the contract, and therefore that the claimants’ claim against them should fail. The college also sought by a counterclaim to recover the amounts already paid under the contract in unjust enrichment, less a sum representing fair market rental value of the building. The claimants contended that the contract was binding on both the college and council as the college's principal, and in the alternative advanced claims in misrepresentation under [section 2\(1\) of the Misrepresentation Act 1967](#) , negligent misstatement at common law and unjust enrichment. They also pleaded a change of position defence in relation to the restitution counterclaim. The college and the council brought contingent claims against each other under [CPR Pt 20](#) for a 100% indemnity/contribution.

Following the hearing and at the request of the court, on 1, 7 and 8 April and 4 and 5 May 2020, the parties made additional written submissions on the change of position defence.

The facts are stated in the judgment, post, paras 1–4, 6–12, 22–54.

Timothy Straker QC and *Pia Dutton* (instructed by *Stephenson Harwood llp*) for the claimants.

Peter Oldham QC and *Christopher Knight* (instructed by *Stone King llp*) for the college.

Daniel Stilitz QC and *Rupert Paines* (instructed by *DAC Beachcroft llp*) for the council.

The court took time for consideration.

7 May 2020. FOXTON J

handed down the following judgment.

Introduction

1. On 10 February 2009, the Isle of Wight Council (“the Council”) approved a request by the Governing Body of Christ the King College (“the College”) to expand its age range and open a sixth form. This decision fell to be implemented against the background of the budgetary constraints which impacted the public sector in the wake of the financial crisis, which significantly reduced the funds available for capital projects. The solution which the College ultimately adopted in the face of that dilemma was to enter into what was described as a hire contract (“the Contract”) for the *1922 construction and hire of a modular building and associated equipment (“the Building”).
2. The Building was provided and assembled by a company called Built Offsite Ltd (“BOS”), a specialist in modular construction. The transaction was structured so that BOS sold the Building to BOSHire Ltd (“BOSHire”) (a joint venture company in which BOS held a 50% interest), who in turn entered into the Contract to lease the Building to the College. Subsequent assignments led to School Facility Management Ltd (“SFM”) and then GCP Asset Finance 1 Ltd (“GCP”) obtaining the right to payments made by the College under the Contract.
3. Against the background of an increasing budget deficit, the College failed to pay the annual instalment under the Contract which fell due in September 2017. The present proceedings followed a year later, in the course of which the legal characteristics of the Contract, and the process by which it came to be entered into, came under much greater scrutiny within the College and the Council than they had received when the College signed the Contract, and the Council signed a letter supportive of the Contract, back in 2013.
4. Both the College and the Council now allege that the Contract was beyond the capacity of the College and outside the authority of those who signed the Contract on a wide range of grounds. The College resists the claims for debt and damages under the Contract, and seeks to recover the amounts it has already paid in unjust enrichment. In response, the claimants contend that the Contract was binding on both the College and the Council as the College's principal, but in the alternative advance claims in misrepresentation, misstatement and unjust enrichment. The College and the Council also bring contingent claims against each other.
5. In *Crédit Suisse v Allerdale Borough Council* [1995] 1 Lloyd's Rep 315 , 373, Colman J noted that the case before him:
“demonstrates that banks and other lending and credit-providing institutions that deal with local authorities are exposed to the major risk of finding that their contracts are unenforceable in circumstances not encountered when dealing with the directors and officers of companies.”

This case shows that this may be equally true of those who lease equipment, goods or buildings to local authorities, or the schools they maintain.

The parties

6. BOSHire is the joint vehicle of two companies, BOS and Summit Asset Management Ltd (“SAM”). As noted above, BOS designs, manufactures and installs modular buildings, principally (but not exclusively) for customers in the education and healthcare sectors. SAM was involved in asset finance, raising finance for transactions for the sale or hire of assets under various forms of asset finance agreement.
7. BOSHire was originally formed in 1993, its role being to put together finance packages for customers who wished to acquire modular buildings from BOS, under an arrangement whereby BOSHire would purchase a building from BOS and then enter into a lease contract with the customer under which regular payments of hire would be made. BOSHire procured external financing for these transactions (which provided the means to *1923 pay BOS and a profit element for BOSHire) by selling the income stream constituted by the payments due under the hire contracts.

8. Mr Timothy Spring, a director of both SAM and BOSHire, described BOSHire's "strategic business model" as being:

"to supply modular buildings to customers in the public sector—principally health and education—where end-user customers are predominantly NHS Trusts, schools or colleges that are subject to statutory restrictions on incurring capital expenditure."

9. It will be apparent that BOSHire is one of a number of companies who operate in the commercial space which has come into existence as a result of limitations on the monies available to public bodies for capital expenditure (whether from allocated or borrowed funds), a space which has been increasingly filled by structured transactions intended to allow the cost of equipment and buildings to be met from periodic payments which, for regulatory and accounting purposes, the public body can treat as revenue expenditure.

10. In circumstances which I describe in greater detail below, on 30 April 2013 BOSHire entered into the Contract with the College for the supply of the Building for a 15-year period. On 5 June 2013, BOSHire assigned the benefit of the Contract to SFM, a subsidiary of BOSHire created for the purpose of raising finance for the Contract. By a receivable sales agreement ("RSA") dated 4 July 2013, SFM assigned its rights, title and interest in rental income under the Contract to GCP, a third party funder from whom BOSHire had raised debt finance for the transaction.

11. The College is a voluntary aided school maintained by the Council. It was formed in 2008 from the merger of two middle schools—one Anglican and one Roman Catholic—and its mission is to provide Christian secondary education on the Isle of Wight. At the times material to the dispute before the court, the College's governing body ("the Governing Body") was chaired by David Lisseter, its principal was Mrs Pat Goodhead and its business manager was (and still is) Ms Kathrin Williams.

12. The Council is the unitary local authority for the Isle of Wight. Its functions include the provision of maintenance and funding to voluntary aided schools on the island. The Council is not responsible for the funding of sixth form education. Between April 2010 and March 2012, sixth form funding was the responsibility of the Young People's Learning Agency ("YPLA"), and, thereafter, the Education Funding Agency.

The witnesses

The claimants' witnesses

13. The claimants called evidence from Mr Timothy Spring and Mr Richard Pierce.

14. Mr Spring is a director of both SFM and BOSHire, with principal responsibility within BOSHire for co-ordinating the financing of transactions and the contractual arrangements between BOSHire and the end user. I found him a careful and honest witness, who was clearly well informed about the ultra vires risk which arises in dealing with public authorities, and who had sought to manage that risk in relation to the Contract. Mr Spring candidly recognised that the more conservative the approach taken to managing the *1924 vires risk, the less profitable the Contract would be for BOSHire, and the less attractive BOSHire's funding proposal would be when seeking to attract financing in the secondary debt market. He was understandably keen to defend the efficacy of the risk management steps which had been taken.

15. Mr Pierce is the chairman and director of BOS, which is a family business, and which specialises in the manufacture and supply of modular buildings. Modular buildings are assembled from prefabricated sections manufactured off site. In some cases, it is feasible to disassemble a building when it is no longer needed, and use the modules elsewhere (the practicality of doing so in this case is an issue on which I have heard evidence, and to which it will be necessary to return). Mr Pierce was also an honest and careful witness. He was very knowledgeable about the technical aspects of modular building construction, and was able to deploy this knowledge to his advantage in the course of his cross-examination. He understood the regulatory sensitivities which attached to the BOSHire business model, and was careful in his dealings with the Council to describe the transaction and its legal incidents appropriately. While Mr Pierce left the detail of the financial and contracting issues to Mr Spring, he was clearly alive to the legal implications of issues canvassed with him in evidence such as the potential resale market for the Building if the College stopped using it at the end of the Contract. For reasons I explain below, I have concluded that the prospects of marketing the Building to a third party purchaser at the end of the Contract were distinctly bleaker than Mr Pierce's evidence suggested.

The College's witnesses

16. The College called two witnesses: Mrs Patricia Goodhead, who was the principal of the College from its foundation in 2008 until she retired in 2018, and Ms Kathrin Williams, who was and remains the College's business manager.

17. Both Mrs Goodhead and Ms Williams were honest witnesses, whose evidence about contemporary events had not been coloured in any way by the dispute which had subsequently arisen. It was clear that they found themselves in a difficult position in 2013, with strong pedagogical reasons for wanting to provide sixth form accommodation, and with considerable pressure from the students, parents and the school's stakeholders to do so. The decisions taken by the College were taken on a collective basis with strong support from the members of the Governing Body, and not by Mrs Goodhead or Ms Williams alone. As I explain below, the strength of the Governing Body's conviction that a sixth form building should be provided, coupled with their view that the College had not been treated fairly by the Council in the provision of funding when compared with other island schools, contributed to what proved to be an unduly optimistic assessment of the College's ability to meet the payments due over the 15-year life of the Contract.

The Council

18. The Council called evidence from Mrs Janet Giles, who was the Council's head of education finance from 1983 to 2014. Once again Mrs Giles was an honest and careful witness, whose evidence I found to be reliable. *1925

The expert witnesses

19. I heard expert accountancy evidence from Mr Christopher Jackson of PwC for the claimants and from Mr Adam Smith from BDO for the defendants. Both experts were fully qualified and doing their best to assist the court in their oral evidence. To a significant degree, their evidence depended on the assumptions and inputs used which they were not in a position to speak to from their own expertise. As I explain below, on the basis of Mr Jackson's own evidence I have concluded that the 5.6% average retail price index ("RPI") rate which Mr Jackson used in his calculations was unrealistic and unduly generous to the claimants.

20. Finally, I heard valuation evidence from Mr Peter Dodson of Liquidity Services for the claimants, and from Mr Jonathan Manley and (on construction costs and state of repair) Mr David Pincott of Lambert Smith Hampton for the defendants. Once again, I have concluded that the experts were appropriately qualified and doing their best to assist the court. While submissions were directed by the parties to the issue of whether it was experience in valuing plant (of which Mr Dodson had more) or traditional buildings (where Mr Manley was undoubtedly the better qualified) that was more relevant to the task at hand, I have concluded that the Buildings under the Hire Contract were essentially a hybrid of these categories, meeting a demand which would traditionally have been fulfilled by conventional building construction through a form of supply which could more quickly deliver the desired end product, and do so in a way which offered the potential benefit of an accounting classification more conducive to the transaction proceeding. Both kinds of experience were of value.

21. Where the experts had material differences of view on significant issues, I have resolved those issues on their merits, having regard to the cogency of the justifications offered by the respective experts and their inherent and practical logic, rather than by relying on any predisposition to regard the evidence of any one expert as being more likely to be reliable than that of another.

The facts

22. As I have stated, the College was formed in September 2008 as a result of the amalgamation of two existing voluntary aided schools, one Roman Catholic and one Anglican. In 2009, the College's permitted age range was extended, which gave it the option to create a sixth form (something which the Roman Catholic and Anglican dioceses had long supported). However, the College did not have sufficient accommodation to house a sixth form.

23. It had been the College's original intention to address this need through funding from a central government programme called "Building Schools for the Future" ("BSF"). However BSF was cancelled in 2010. The College held discussions with two other potential providers of sixth form accommodation, McAvoy Group Ltd and an organisation called "Building Schools for Nothing". The College also sought to raise money from the Anglican and Roman Catholic dioceses for a building and

equipment which it originally estimated would involve a capital cost of £4,514,000. The dioceses were unable to meet this funding requirement, but the Roman Catholic diocese suggested that the College approach BOS, with whom it had had previous dealings. *1926

24. Discussions between the College and BOS began towards the end of 2011. BOS was represented in those discussions by its sales director (and Mr Pierce's son-in-law), Mr Neil Blow. BOS soon became the College's preferred candidate to provide a sixth form building, because the College believed it would complete the project more quickly in circumstances in which the first sixth form entry was arriving in September 2012. It was originally anticipated that the Building would be contracted for in stages, reflecting the fact that in the first year, there would only be one year of sixth formers to accommodate. Ms Williams explained BOS's offering to the Governing Body in a letter of 10 February 2012 as follows:

“This can be done over a period of 15 years; the building would then be rented by the College for that time with the responsibility for the refurbishment of the building remaining with the hirer (Built Off Site), hence reducing the maintenance costs for the College during the rental period. This option would enable the College to use its own revenue budget to cover the rental payments and we have produced a revised budget plan that shows that this is possible within the same budget recovery that has currently been licensed by the local authority.”

25. The proposal was discussed at a meeting of the Governing Body on 21 February 2012, at which Mr Blow was present. The governors were told that “the initial value of the building would be in the region of £2.2m” and that “the cost of seven years’ rent approximately equates to the value of the building, obviously making the hire agreement much more expensive over the full term of the agreement”. It was also stated that “the hire agreement is not a loan of any kind” and “sits outside of public sector borrowing”.

26. Some of the aspects of the proposed transaction which Mr Blow described to the College were either imperfectly conveyed or understood (for example as to responsibility for maintenance, whether the College would have a legal right to purchase the Building during or at the end of the lease term and who would be responsible for removing the Building from the site at the end of the Contract) but before the Contract was concluded, I find that Mr Pierce had accurately explained the position and corrected any previous misunderstandings in these respects.

27. The College had operated with a budget deficit from its creation in 2008, and required the Council's permission to do so. On 22 February 2012 the College sought the Council's permission to extend that deficit so as to allow the College to enter into the 15-year hire agreement with BOS in respect of the first phase of the Building. The proposal which the College put forward envisaged the deficit being paid off by 2014/2015, with the College having the option to purchase the Building during the term of the agreement. The Council expressed some concern about the amounts involved. Janet Newton, the Council's head of commissioning for education services, commented on 22 February 2012 that “their case has more holes in it than Gouda cheese”. Other Council communications noted (correctly) that the Council had no responsibility for funding sixth form education. Nonetheless, in March 2012, Mr Beynon, the Council's chief executive, informed the College that the Council was willing to extend the College's deficit to meet the costs of hire.

28. As would be expected for a public body, the College is subject to a number of statutory restrictions as to the financial commitments it can undertake. I will consider the precise nature of the particular restrictions in *1927 issue in this case (and whether they impact on the ambit of the College's contractual capacity) in due course. The understanding of Mr Spring in 2012 in relation to this issue was as follows:

“The statutory scheme in which maintained schools operate prohibits them from entering into borrowing arrangements without the approval of the Secretary of State for Education. I was very well aware that a finance lease is considered to constitute borrowing, so a maintained school cannot enter into such an agreement without the consent of the Secretary of State ... I briefly discussed with Richard the possibility that the College could be persuaded to seek the consent of the Secretary of State to enter into a borrowing arrangement but we ruled this out as impracticable and likely to result in a self-defeating delay to the project.”

29. Central to Mr Spring's approach in addressing this issue was ensuring that the Contract would, in accounting classification terms, be an operating lease and not a finance lease. I received expert accounting evidence on the differences between operating

and finance leases, which I address below, but a crucial and essential aspect of the distinction is whether the usual risks and rewards of ownership are substantially transferred to the lessee. On 6 March 2012 Mr Spring prepared a draft letter for the College setting out BOS Hire's likely requirements to address "the operating lease/intra vires" question. The draft letter (which was not, in the event, sent) referred to a "statutory constraint" that "the College does not have the power to enter into a 'finance lease' of assets (which, for accounting purposes, is regarded as a loan arrangement) without the consent of the Secretary of State for Education". The draft letter continued:

"We are confident, given the nature and explicit terms of the hire contract and the financial terms contained in and surrounding it, that the hire contract is an 'operating lease', so does not require SoS approval. However, in order to satisfy our lenders that is indeed the case, we envisage that we will be required to seek the following:

- Minutes of the meeting of the Board of Governors of the College approving the project, the terms of the hire contract, confirming the Governors' opinion that the hire contract is an 'operating lease' and authorising you to sign the hire contract on behalf of the College.
- Confirmation from the Isle of Wight Council, as the funding [local education authority ('LEA')], of approval of the hire contract and confirmation that it is, in the Council's view, an operating lease; accordingly that it is within the powers of the College to enter into and perform the hire contract."

30. In order to give further consideration to this issue, Mr Spring engaged Ms Sam Yardley, a partner in Watson Farley & Williams llp specialising in asset finance, to advise on the transaction.

31. In the event, there were difficulties in obtaining planning permission for the Building, with the result that no contract had been signed, and no Building was available, by September 2012. For this reason, the College's first sixth form entry had to be accommodated in less than satisfactory *1928 circumstances using various sites across the College, something which placed the College under further pressure to ensure that the issue was resolved by the time the second sixth form entry arrived in September 2013. In the meantime, and with the encouragement and support of the College, BOS began the ground works, erecting the foundations on which the Building would stand.

32. The planning issues were resolved by December 2012. By this date the College had decided to contract for the Building in one phase, with a view to having it available by September 2013 when the College would have to accommodate two sixth form years. In the course of renewed exchanges between BOS and the College, on 17 January 2013, Mr Pierce explained the position so far as any option to purchase and maintenance were concerned in the following terms:

"We acknowledge that an undertaking has been given to redecorate the facility internally at the five-year period, this redecoration would be confined to painted surfaces and floor coverings and would not cover the replacement repair or redecoration of any areas or items affected by accidental damage, misuse or vandalism albeit I am sure the latter two would be highly unlikely. Should you wish to purchase the building after a period of time then that is an option we would consider and not unreasonably reject. It is not possible or practicable at this stage to list out what the likely costs would be as we would need to approach the funding partners at the stage you are considering purchase to have them calculate the current replacement value of the facility and then dependent upon the length of time you have had the facility on hire for a discount against the replacement value would be given. Clearly the further through the term you are the higher discount would be. Additionally as I am sure you will recall we did discuss that we cannot write the option to purchase into the agreement as it would substantially change the legal status and tax treatment of the transaction."

33. The vagueness in this communication as to the price at which the College might be able to purchase the Building at the end of the 15-year period was not resolved in subsequent communications during the life of the Contract, or indeed in the course of the trial.

34. In January 2013, Mr Pierce also pushed the College for payment of the £400,000 BOS had already incurred on preparatory works. Mrs Goodhead, after speaking to Mr Pierce, explained in an e-mail of 21 January 2013 that "it was obvious during the conversation that Richard's real fear is still the [local authority] stopping this going ahead and the money his firm would lose if that happened". In exchanges in the course of the evening of 21 January 2013, Mrs Goodhead and Ms Williams noted how

difficult it would be to find this money from the College's 2012/2013 budget, with Mrs Goodhead signing off at 22.17 with the suggestion that they "sleep on it and see what we can sort tomorrow". She concluded "we can't not let this happen, obviously".

35. BOSHire provided the College with a draft of the Contract which the College sent to its legal adviser Mr Guthrie McGruer of Blake Laphorn. Mr McGruer made contact with Mr Pierce in January 2013 to discuss the terms of the proposed Contract, and the provision of a side-letter which would record BOSHire's willingness to give favourable consideration to a request by the College to purchase the Building during the 15-year lease. *1929

36. A representative of the Catholic Diocese involved with the College, Ms Hilary Foley, e-mailed Mr Pierce suggesting that the proposal would have to be considered at a further meeting of the Governing Body before the Contract could be approved. Apparently frustrated at the time it was taking to sign off on the Contract, particularly given the £400,000 of work BOS had already undertaken, Mr Pierce sent an e-mail to the College on 28 January 2013 stating:

"I have forwarded Guthrie's and Hilary's e-mails to our funding partners for comment and this has resulted in them determining that they will need undertakings from both the council and the Board of Governors that they are satisfied that the contract meets the requirements of classification as an operating lease. Whilst this should not be a problem to acquire as it is a fairly straightforward event it will further delay all the necessary paperwork being in place. I have instructed our funding partner to assemble the necessary undertaking as soon as possible as a matter of extreme urgency so that we can present the Authority and the Board with documents to approve and sign."

37. Mr Spring and Mr Pierce had exchanges about the draft of the proposed side-letter which Mr Guthrie had prepared, and also about the documented assurances they should seek from the College and the Council with regard to the College's ability to enter into the Contract. Draft documents were prepared, which at that stage envisaged a certificate from the College confirming that it had discussed the classification of the Contract with its auditors who had confirmed it was an operating lease.

38. A meeting took place between Mr Pierce, Mr Spring, Mrs Goodhead, Mr Lisseter and Mr McGruer in Oxford on 4 February 2013 to address a number of topics: the level of comfort which could be given by BOSHire on the subject of the College's ability to purchase the Building during the life of the Contract; what provision should be made for the possibility that the College might cease to be a maintained school but assume academy status during the life of the Contract; and what statements would be made to BOSHire by the College and/or the Council in relation to the vires issue. The College made it clear that it was reluctant to approach the Council for some form of written reassurance for BOSHire and, as will be seen, the final form of assurances provided in both directions were diluted versions of those originally requested.

39. The possibility that the College might acquire academy status was addressed in an additional clause in the Contract which I set out below. The College's desire for an option to acquire the Building during the Contract was the subject of a side-letter which did not give the College a legal right to purchase, but confirmed that BOSHire would look favourably on such a request. So far as the vires issue was concerned, amendments were made to the letter to be sought from the College, but the issue of what the Council would be asked to provide remained open. On 13 February 2013 Mr Spring informed Mr Guthrie that:

"We have deliberated at considerable length on how best to secure the reassurance needed. Our suggestion is that the governing body (or Pat Goodhead on its behalf) should write to the Council/Steve Beynon requesting confirmation on certain matters." *1930

A draft letter was prepared by BOSHire, with input from its solicitors Watson, Farley & Williams llp, for Mrs Goodhead to send to the Council.

40. The suite of transaction documents was considered and approved by the College finance committee. A meeting of the Governing Body was then convened on 13 February 2013, at which Mr Lisseter is recorded as having stated:

"The governing body has been on a very long journey with this building project and there has been much scrutiny. The governors have been supported with legal advice at all stages from the [local authority], Built Offsite and independently from Blake Laphorne [sic] ...

“The Finance Committee has scrutinised these documents following legal advice. Janet Giles of the [local authority] confirmed in a meeting with PGO [Mrs Goodhead] this morning that she is very happy with the College's budget recovery and the hire contract.”

41. It is clear on the evidence that these statements, at least as recorded in the minutes, somewhat overstated the position. While the College had benefited from information provided by BOS, and from legal advice from Blake Laphorn, the College had not received legal advice from the Council. Further, I accept Mrs Giles' evidence that, while she had confirmed that the College's paperwork for the budget extension requested by the College was in order, and that the extension would be granted, she had not stated she was “happy” with the extension and had not seen or expressed any views on the Contract.

42. The Governing Body took the decision to proceed, and Mr Lisseter signed the Contract and the letter of reassurance that evening. I shall refer to the letter provided by the College—which Mr Lisseter signed on 13 February 2013—as “the College's Letter”.

43. At 12.54 the following day, Ms Goodhead sent a letter in the form BOSHire had prepared to the Council asking the Council to provide a letter to the College which the College could show to BOSHire. At 15.14 on the same day, Mrs Giles informed Mrs Goodhead that Mr Beynon had confirmed he was happy to sign a letter in the requested terms, and the signed letter was sent out at 19.15 that evening. When Mr Spring saw the letter the next morning, he observed to Mr Pierce “that was really quick”. I shall refer to the letter signed by the Council as “the Council's Letter”.

44. Armed with the College's and the Council's Letters, BOSHire set about raising the necessary funding. Gravis Capital Partners llp agreed “in principle” to provide funding on 28 March 2013. Meanwhile, the College was already running into financial difficulties, exacerbated by Blake Laphorn's costs, the higher than expected payment to BOS and a lower than expected contribution from the dioceses by way of locally co-ordinated voluntary aided programme payments. On 18 March 2013, the College asked the Council for a contribution of £200,000 towards the Contract. The request was refused, but on 5 April 2013 the Council's acting chief executive, Mr Burbage (who had replaced Mr Beynon) confirmed that the Council would approve an increase to the College's budget deficit “in order to allow the College to meet the costs from its revenue budget”.

45. With funding in place, Mr Pierce signed the Contract for BOSHire on 30 April 2013. On the same day, BOSHire assigned its rights under the **1931* Contract to SFM, which had been incorporated on 22 April 2013, and the College acknowledged that assignment in writing on 5 June 2013. On 4 July 2013 SFM entered into a further assignment with GCP on the terms of the RSA.

46. In assembling the Building it became apparent that various further works were necessary to address matters such as the electricity supply and sockets, the need for a fire hydrant and a boost to the water supply. In the absence of funding alternatives the amounts due under the Contract were increased by two variations: the first, dated 5 June 2013, increased the initial payment from £915,000 to £950,579, the second payment from £305,000 to £316,000 and the annual payments thereafter from £610,000 to £633,719. The second, dated 5 September 2013, increased these amounts to £1,001,762, £333,920 and £667,851 respectively (exclusive of VAT).

47. The College took possession of the Building on 5 September 2013. It is apparent from the technical specification prepared by BOS that in addition to providing prefabricated modules, external cladding, roofing, electrics and plumbing, the Contract also covered the provision of internal lining and wall finish for the modules, platform lifts, units, power and gas (but not the equipment) for the kitchen, art teaching, resistant materials and graphics rooms and the science laboratories.

48. The payments made under the Contract led to a substantial increase in the level of the College's deficit. While the College had filed a budget report with the Council in September 2013 projecting a return to surplus by 2016/2017, on 10 October 2013 Mrs Williams wrote to the Council stating that the College's previous budget was no longer achievable, “mainly but not exclusively due to the additional expenditure with the sixth form centre”, and confirming that the College wanted to extend its deficit. In February 2014 the Council's education finance team carried out a full review of the College's budgeted income and expenditure and concluded that “the sixth form centre is not affordable through the current funding formula”.

49. On 6 May 2014 the College informed the Council that it could not prepare a budget plan showing a full recovery from its current deficit without financial support from the Council, and the College sought an additional contribution from the Council of £200,000 a year for a five-year period. The College's consistent financial reporting to the Council for the year 2013/2014 forecast a deficit of £1,045,686.16 at the year end.

50. Matters did not improve thereafter. On 8 June 2016 the Council served a formal notice of concern on the College. This stated:

“As a result of the deficit the College is completely reliant on cash flow support from the Isle of Wight Council and support for debt. It is unacceptable to expect the local council taxpayer to support an increased College deficit going forward.

“We understand that the majority of the current [circa] £2m (and rising) overspend has been caused by the decision by the College in 2012/2013 to lease the sixth form units, a highly expensive financial arrangement that has, to date, proved impossible to service from the school's revenue budgets.

“However, in addition to the lease arrangement, the College has struggled to set and keep to a balanced in-year revenue budget since 2008/2009. Successive three-year budget forecasts have proven to be **1932* overly optimistic and the school has been unable to halt or in any way reverse the spiralling debt it now faces.

“Various conversations have suggested consensus between the College and the local authority that this situation is not sustainable, but, as yet, the College has found no solution and the position continues to worsen.”

51. The notice of concern imposed a number of requirements, including that “the College prepares a recovery plan (lease costs included) with detailed actions, timescales and governance arrangements which results in a surplus position within five years”. It also imposed a requirement that no purchases over £5,000 were to be made without the approval of the Council's director of finance.

52. In September 2017 the College submitted a budget plan which involved increasing its existing budget deficit of £2.6m by a further £650,000. The Council refused to authorise any further advances of funds to the College, and communicated this to the College on 8 September 2017. A final warning to return to a balanced budget was served on the College on 8 January 2018.

53. The College failed to make the annual payment of £667,841 payable under the Contract on 5 September 2017. There were attempts at meetings and in correspondence over the following two months to resolve matters, but by 22 November 2017, matters between the claimants and the College had entered pre-litigation mode.

54. On 22 November 2017 SFM sent the College a formal notice of default under the Contract. On 9 April 2018 the College made it clear that it had no intention of paying any further amounts, and it articulated its ultra vires defence for the first time. On 11 April 2018 SFM sent a letter terminating the Contract, and informed the College that it was no longer in lawful possession of the Building with its consent and should cease using it. The claim form was issued by SFM on 8 November 2018, with BOSHire and GCP being added as claimants by later amendments.

The contract

55. The key provisions of the Contract were as follows:

- (i) The College requested BOSHire to purchase the Building (described as “a double storey sixth form teaching accommodation block constructed from 81 relocatable units”) from BOS.
- (ii) The College agreed to take the Building on hire in return for paying the hire charges to which I have already referred for a minimum period of 180 months (15 years).
- (iii) Hire was payable even if the Building “was not fully operational”, with interest at 4% over Barclays base rate (compounded monthly) in the event of late payment.
- (iv) It was the College's responsibility to ensure that the Building complied with applicable statutes and regulations so far as use was concerned, and to maintain the Building in good and substantial repair and condition (fair wear and tear excepted).
- (v) On termination, it was the College's responsibility to return the Building to BOSHire, with the College being liable “for all costs of **1933* inspection, loading, unloading and transportation”. The equipment was to be returned in good and reasonably clean condition. Failing redelivery in this condition, the College was liable to pay BOSHire the costs of restoration, with hire continuing to be payable until contractual redelivery took place.
- (vi) The College bore all risk of loss and damage, and was obliged to insure the Building for £6,953,000.

56. There are certain clauses in the Contract which have featured extensively in the course of argument and which merit more extended quotation.

57. First, clause 2.6.2 addressed termination for the College's repudiatory breach and provided that in that eventuality:

“2.6.2.1 the Customer [the College] will no longer be in possession of the equipment with BOSHire's consent and if the customer has not redelivered the equipment in accordance with clause 2.3.6, BOSHire or its agent may enter the customer's site without further permission and take possession of the equipment; and

“2.6.2 the Customer will immediately pay to BOSHire, as an agreed pre-estimate of the loss suffered by BOSHire as a consequence of termination, an amount equal to the aggregate of all Hire Charges then due but unpaid together with interest due under clause 2.2.5; plus all costs incurred by BOSHire in enforcing or seeking to enforce this contract and in locating and recovering the equipment; plus the sum of all further charges which, but for termination, would have fallen due during the minimum hire period, each discounted at 3% per annum for accelerated payment; plus all other sums due under this Contract.”

58. Second, clause 2.6.3 addressed what was to happen if the College was converted to academy status (which would have the effect that the Council was no longer obliged to maintain it). It provided that if the College began taking steps towards such a conversion it would:

“notify BOSHire and shall provide such information as BOSHire may reasonably require in connection therewith. BOSHire shall consider such information in good faith with a view to novating this Contract to the Academy entity (‘the Academy Trust’) on such terms as the Customer, the Academy Trust and BOSHire may agree. If the parties fail to reach agreement, then the Customer may give not less than three months’ written notice to BOSHire to terminate the hiring of the equipment and may require BOSHire to sell the equipment to the Academy Trust. Upon such termination (‘the termination date’) the Customer shall pay to BOSHire the amount that would be due pursuant to clause 2.6.2.2 upon termination under clause 2.6 and BOSHire shall sell the equipment to the Academy Trust on terms to be agreed between the parties acting in good faith.”

59. Third, clause 2.7.1 allowed BOSHire to assign “the benefit of this Contract or the right to receive payment of Hire Charges and other sums payable under this Contract” to another party.

60. Finally, although this document was not contractual in effect, the side-letter provided by BOSHire, and later SFM, to the College (“the Side-Letter”) stated: **1934*

“You have requested that we provide an indication of our position should you wish to terminate the Contract and to purchase the equipment ...

“We would be willing to consider such a request (without any obligation to accept) and, in our current opinion, acceptance of such a request by us would likely require you to pay to us: (a) a sum equal to the aggregate of all the hire charges (as defined) remaining to be paid up to the expiry date, discounted at a percentage rate to be agreed between us for accelerated payment; plus (b) a sum as may be agreed between us that represents the anticipated value of the equipment as at the expiry date, discounted at a percentage rate to be agreed between us to reflect early receipt; plus all applicable VAT, costs and expenses.”

The statutory scheme

61. Educational provision by the Council and the College takes place within a complex statutory and regulatory framework. In this section, I set out the key enactments and provisions on which the Council and the College found their ultra vires defence, and also their contingent claims against each other.

The SSFA and the Education Act 2002

62. Provision for the legal status of the governing bodies of maintained schools was made in [section 36](#) of and [Schedules 9 and 10 to the School Standards Framework Act 1998](#) (“the SSFA”). [Section 36](#) provided: “Each maintained school shall have a governing body, which shall be a body corporate constituted in accordance with [Schedule 9](#)”, and that [Schedule 10](#) would have effect in relation to the general powers of the governing body and other matters relating to it as a body corporate.

63. Those provisions were essentially repeated in [section 19\(1\) of the Education Act 2002](#), which provided that each maintained school “shall have a governing body which shall be a body corporate in accordance with regulations”. References in this case to the capacity or vires of the College are, therefore, a shorthand for references to the capacity of the body corporate established by statute and constituted in the form of the Governing Body. [Section 19\(6\)](#) provides that “[Schedule 1](#) (which contains general provisions relating to the governing body as a body corporate) shall have effect”, and it is in that Schedule that the capacity of the Governing Body is principally to be found.

64. [Paragraph 3 of Schedule 1](#) (as amended by [paragraph 11\(3\) of Schedule 2\(1\) to the Local Education Authorities and Children's Services Authorities \(Integration of Functions\) Order 2010](#)) provides:

“(1) The governing body may do anything which appears to them to be necessary or expedient for the purposes of, or in connection with— (a) the conduct of the school ...”

“(3) The powers conferred by [sub-paragraph (1)] ... include, in particular, power— (a) to borrow such sums as the governing body think fit and, in connection with such borrowing, to grant any mortgage, charge or other security over any land or other property of the governing **1935* body, (b) to acquire and dispose of land and other property, (c) to enter into contracts, (d) to invest any sums not immediately required for the purposes of carrying on any activities they have power to carry on, (e) to accept gifts of money, land or other property and apply it, or hold and administer it on trust, for any of those purposes ...

“(4) The power to borrow money and grant security mentioned in sub-paragraph (3)(a) may only be exercised with the written consent— (a) of the Secretary of State (in relation to England) or the National Assembly for Wales (in relation to Wales) ... and any such consent may be given for particular borrowing or for borrowing of a particular class.”

“(7) Where the school is a foundation, voluntary aided or foundation special school, the power to enter into contracts mentioned in sub-paragraph (3)(c) includes power to enter into contracts for the employment of teachers and other staff, but no such contracts may be entered into by the governing body of a community, voluntary controlled or community special school or of a maintained nursery school.

“(8) Sub-paragraphs (1) to (3) have effect subject to— (a) any provisions of the school's instrument of government, and (b) any provisions of a scheme under [section 48](#) of the 1998 Act (local authorities' financial schemes) which relates to the school.”

65. In addition to specifying the capacity of the Governing Body, the [SSFA](#) also contains numerous provisions addressing the financial relationship between the Council and the College.

66. By [section 22 of the SSFA](#), the Council is under a duty to fund the maintained schools in its area. For voluntary aided schools such as the College, [section 22\(5\)\(a\) of the SSFA](#) provides that the Council's duty to maintain includes: “the duty of defraying all the expenses of maintaining it, except any expenditure that by virtue of [paragraph 3 of Schedule 3](#) is to be met by the governing body ...”

67. [Paragraph 3 of Schedule 3](#) (as amended by [section 184](#) of and [paragraph 1 of Schedule 18\(6\) to the Education and Inspections Act 2006](#) and [paragraph 10\(2\) of Schedule 2\(1\) to the 2020 Order](#)), provides:

“(1) In the case of a voluntary aided school, the governing body of the school are responsible for meeting all capital expenditure in relation to the school premises subject to sub-paragraph (2) below.

“(2) The duty in sub-paragraph (1) does not extend— (a) to capital expenditure in relation to playing fields or any building or other structure erected thereon in connection with the use of playing fields, but does extend to capital expenditure in relation to boundary walls and fences; (b) to capital expenditure necessary in consequence of the use of the school premises, in pursuance of a direction or requirement of the [local authority], for purposes other than those of the school; (c) to capital expenditure on the provision of any new site which the [local authority] is to provide by virtue of paragraph 4 of this Schedule.”

68. Paragraphs 9A–9B of Schedule 3 provide, in broad terms, that capital expenditure is expenditure which “falls to be capitalised in accordance with proper accounting practices”. *1936

69. The mechanism by which the Council provides the funding which it is obliged to provide to maintained schools is through allocating a budget share for each funding period (section 45 of the SSFA), which is the amount the Council decides to allocate to the school out of its individual schools budget for that funding period (section 47 of the SSFA). In most circumstances, reflecting the autonomy which maintained schools are intended to have, the budget share is to be made available to the maintained school as a delegated budget (sections 49–50 of the SSFA) meaning, in effect, that that part of the budget is managed by the governing body of the maintained school and not the Council.

70. Section 48 (as amended by section 57 of and paragraph 3 of Schedule 5 to the Education and Inspections Act 2006), provides that each local authority “shall maintain a scheme dealing with such matters connected with the financing of the schools maintained by the authority” as are required to be dealt with by regulations made by the Secretary of State or any provision of the relevant part of the SSFA .

71. Section 49 (as amended by section 215 of and paragraph 100(2)(3) of Schedule 21 to the Education Act 2002 , section 99 of and paragraph 19(7) of Schedule 5(2) to the School Standards and Organisation (Wales) Act 2013 and paragraph 10(2) (8) of Schedule 2 to the 2010 Order) provides: *1937

“(1) Every maintained school shall have a delegated budget.”

“(4) Subject to— (a) section 50 (right of governing body to spend budget share where school has a delegated budget), (b) paragraph 4 of Schedule 15 (power of governing body to spend amounts out of budget share where delegation of budget suspended), (c) section 489(2) of the Education Act 1996 (education standards grants), and (d) any provisions of the scheme, a local authority may not delegate to the governing body of any maintained school the power to spend any part of the authority's non-schools education budget or schools budget.

“(5) Any amount made available by a local authority to the governing body of a maintained school whether under section 50 or otherwise— (a) shall remain the property of the authority until spent by the governing body or the head teacher; and (b) when spent by the governing body or the head teacher, shall be taken to be spent by them or him as the authority's agent.

“(6) Subsection (5)(b) does not apply to any such amount where it is spent— (a) by way of repayment of the principal of, or interest on, a loan, or (b) (in the case of a voluntary aided school) to meet expenses payable by the governing body under paragraph 3(1) or (2) of Schedule 3 , paragraph 14(2) of Schedule 6 , or paragraph 8 of Schedule 8 to the Education Act 2002 section 75(2)(b) of, or paragraph 4 of Schedule 3 to, the Schools Standards and Organisation (Wales) Act 2013 .

“(7) In this Part— (a) references to a school having a delegated budget are references to the governing body of the school being entitled to manage the school's budget share; and (b) where a school has a delegated budget the governing body are accordingly said to have a right to a delegated budget.”

72. Section 50 (as amended by section 117 of and paragraph 8 of Schedule 18 to the Education Act 2005) provides:

“(1) Where a maintained school has a delegated budget in respect of the whole or part of a funding period the local authority shall secure that in respect of that period there is available to be spent by the governing body— (a) where the school has a delegated budget in respect of the whole of that period, a sum equal to the school's budget share for the period, or (b) where the school has a delegated budget in respect of only part of that period, a sum equal to that portion of the school's budget share for the period which has not been spent.

“(2) The times at which, and the manner in which, any amounts are made available by the authority to the governing body in respect of any such sum shall be such as may be provided by or under the scheme.

“(3) Subject to any provision made by or under the scheme, the governing body may spend any such amounts as they think fit— (a) for any purposes of the school; or (b) (subject also to any prescribed conditions) for such purposes as may be prescribed.”

“(6) The governing body may delegate to the head teacher, to such extent as may be permitted by or under the scheme, their powers under subsection (3) in relation to any amount such as is mentioned in that subsection.

“(7) The governors of a school shall not incur any personal liability in respect of anything done in good faith in the exercise or purported exercise of their powers under subsection (3) or (6).”

SEYFER 2012

73. Further and more detailed provision for the financing of maintained schools was made under Regulations issued under the [SSFA](#) in the form of the [School and Early Years Finance \(England\) Regulations 2012](#) (“SEYFER 2012”). These Regulations were issued by the Secretary of State for Education pursuant to various provisions of the [SSFA](#) and also [section 24\(3\) of the Education Act 2002](#) .

74. There are two particular provisions of [SEYFER 2012](#) which are relied upon by the College and the Council as further limiting the capacity or vires of the College.

75. First, [regulation 6](#) prescribes the contents of the schools budget as follows:

“(1) The classes or descriptions of local authority expenditure specified in [sub-paragraphs \(a\) to \(e\) and Schedule 2](#) are prescribed for the purposes of [section 45A\(2\)](#) of the 1998 Act and the determination of a local authority's schools budget, subject to paragraph (2) and the exceptions in regulation 7— (a) expenditure on the provision and maintenance of maintained schools and on the education of pupils registered at maintained schools ...”

76. [Regulation 7](#) then sets out matters which cannot form part of a local authority's schools budget as follows:

“A local authority's non-schools education budget or schools budget must not include the following classes or descriptions of expenditure— (a) capital expenditure ... (b) expenditure on capital financing, other than expenditure incurred— (i) on prudential borrowing ...” **1938*

77. [Regulation 1\(4\)](#) provides that “capital expenditure” means “expenditure of a local authority which falls to be capitalised in accordance with proper practices, or expenditure treated as capital expenditure by virtue of any regulations or directions made under [section 16 of the Local Government Act 2003](#) ”. Proper practices are in turn defined as:

“those accounting practices which a local authority are required to follow by virtue of any enactment, or which, so far as they are consistent with any such enactment are generally regarded, whether by reference to any generally recognised published

code or otherwise, as proper accounting practices to be followed in the keeping of the accounts of local authorities, either generally or of the description concerned.”

The Scheme

78. As I have mentioned, [section 48 of the SSFA](#) provided for each local authority to maintain a scheme “dealing with such matters connected with the financing of the schools maintained by the authority” as are required to be dealt with by regulations made by the Secretary of State or the [SSFA](#) itself.

79. The Council's 2012 Scheme (“the Scheme”) provided at para 1.1:

“The financial controls within which delegation works are set out in a scheme made by the authority in accordance with [section 48](#) of the Act and approved by the Secretary of State ... Subject to the provisions of the Scheme, governing bodies may spend budget shares for the purposes of their school ... An authority may suspend a school's right to a delegated budget if the provisions of the school financing scheme (or rules applied by the scheme) have been substantially or persistently breached, or if the budget has not been managed satisfactorily.”

80. Para 1.2 identifies the purpose of the Scheme as follows: “This scheme sets out the financial relationship between the authority and the maintained schools which it funds. The requirements of the Scheme in relation to financial management and associated issues are binding on both parties.”

81. The College and the Council relied upon a number of provisions of the Scheme as limiting the vires or capacity of the College. These are considered below.

82. Before considering the College and the Council's various vires challenges, it is first necessary to consider whether, if there was or had been a valid contract concluded, it was between BOSHire and the College, or BOSHire and the Council.

Did the College act as the agent of the Council?

83. The conflicting interests in multi-party litigation can sometimes give rise to strange bedfellows. One issue on which the claimants and the College found themselves unlikely allies was in the suggestion that, in purporting to enter into the Contract with BOSHire, the College was acting as the Council's agent such that it was the Council, and not the College, which was liable on the Contract if it was valid. That conclusion was not pushed by the College to its logical conclusion: for example the College relies on its own public law limitations, rather than on limitations on the Council's ability to contract, to establish that the Contract is not binding, and the College seeks to recover **1939* the monies which it says were mistakenly paid under the Contract in its own name and for itself, and not for its alleged principal.

84. Any suggestion that the College was the Council's agent *as a matter of fact* in this case can be immediately discounted. From BOSHire's perspective, the Contract clearly identifies its contractual counterparty as the College, and the Contract contains no reference to the Council. The letter of 14 February 2013 which the College provided to the claimants, in terms agreed between the legal representatives of both parties, specifically referred to a contract to be entered into by the College, and contained no hint that the Council was the contracting party. Further the letter drafted by BOSHire which the Council signed on 14 February 2013, which was addressed to the College, and, with the Council's knowledge, provided by the College to BOSHire, was wholly inconsistent with any suggestion that the College would be entering into the Contract on the Council's behalf. Para 2 of that letter stated that:

“the Council agrees that the expenditure to be incurred by the Governing Body under the Hire Contract and otherwise in connection with the project falls within the delegated budget *and is not the responsibility of the Council under the [Schools and Standards Framework Act 1998](#) or otherwise.*” (Emphasis added.)

85. There are numerous other contemporary documents disclosed by BOS Hire, the College and the Council which make it clear that everyone was proceeding on the basis that the College, and not the Council, was the contracting party, and which are wholly inconsistent with any suggestion that the Council held the College out as authorised to conclude a contract on the Council's behalf. The pre-action correspondence of the claimants and the College did not involve the Council or contain any suggestion that the Council was the contracting party. The only contemporaneous document said to point the other way was the draft letter, prepared by BOS Hire to go to the College but not sent, which referred to the College as “the de facto agent of the Council as the funding [local education authority]”. However, far from supporting the agency case, the draft letter effectively accepts that the College was not the Council's de jure agent. The other terms of the draft make it clear that it was the College, and not the Council, which would be the contracting party, and the statement relied upon does no more than reflect the College's financial dependence on the Council. In any event, this unsent draft letter cannot carry the day against the weight and clear effect of the documents which did cross the line. The reality of the position was accurately captured in the evidence of Mrs Giles who said:

“It was made very clear to the school right from the start of these discussions that this was—the contract was entered into by the governing body on behalf of the school and not on behalf of the local authority. Because the school was an aided school, the local authority was very clear that they would not provide funding for this, could not provide funding for this, and that the contract was entered into by the school independently.”

86. The argument that, nonetheless, the College was acting as the Council's agent was advanced on two bases. The first, which I can deal with relatively briefly, was the suggestion that such an agency was implicit in the local authority's duty to fund maintained schools under [section 22\(1\) of the SSFA](#), *1940 and that the assumption that maintained schools acted as agents had been received wisdom since the [Education Act 1944](#). I was not pointed to any legal material in existence in advance of the [SSFA](#) which provides any support for the view that a maintained school always contracted as the agent of the maintaining authority. There is an obvious distinction between one party having an obligation under a statute (the mechanisms for enforcement of which were not subject to any significant discussion before me) to fund the activities of another, and one party concluding contracts on behalf of another.

87. In any event, monies coming from a local authority are far from the only source of funds available to a maintained school. Most pertinently, given that the present dispute arises from the College's desire to open a sixth form, funding for sixth form education comes not from local authorities but centrally, from the YPLA. The difficulties with the argument that a college, in incurring expenditure relating to the provision of sixth form education, contracts as agent of the local authority, which is not legally obliged to and does not fund that education, are obvious. I note there was no suggestion that the funding provided to the College by the YPLA for sixth form education had the effect that the College contracted as agent for the YPLA when spending those funds.

88. The second, and the principal ground, relied upon to establish the agency was [section 49\(5\) and \(6\)](#), as amended, of the [SSFA](#) which it is convenient to set out once again here:

“(5) Any amount made available by a local authority to the governing body of a maintained school whether under [section 50](#) or otherwise— (a) shall remain the property of the authority until spent by the governing body or the head teacher; and (b) when spent by the governing body or the head teacher, shall be taken to be spent by them or him as the authority's agent.

“(6) Subsection (5)(b) does not apply to any such amount where it is spent— (a) by way of repayment of the principal of, or interest on, a loan, or (b) (in the case of a voluntary aided school) to meet expenses payable by the governing body under [various provisions concerned with capital expenditure].”

89. On its own, the language of [section 49\(5\)](#) lends only limited support for the view that, outside the exceptions in [section 49\(6\)](#), a maintained school contracts as the agent of its maintaining authority. The language addresses the characterisation of money spent, with no reference to contracting at all, and it does so in such a way as to suggest that the provision applies a “deemed” character to such payments (“shall be taken to be spent”) which may differ from the legal character in which they were made. The focus in [section 49\(5\)](#) on the way in which payments are “taken to be spent” does not readily offer an answer to the logically and chronologically anterior question of “who are the parties to the contract under which the payments fall to be made?”.

90. There are also various practical difficulties with the College's argument. I posited the hypothesis to Mr Peter Oldham QC in closing submissions of what would happen if a maintained school entered into a contract with a contractor without any settled intention as to the funds which it would use to meet its payment obligations, but used local authority funds to make the first payment one year later. Mr Oldham said that in such **1941* a case, [section 49\(5\)](#) would have the effect that the local authority would retrospectively be deemed the contracting party once the payment had been made, thereby changing the identity of the contracting party. It would seem to follow from the College's argument that at a stage when no amounts had been paid by the College under such a contract, the claim to recover a debt would be a claim against the College, but once some payment had been made, the Council would become liable.

91. The difficulties with the College's argument do not end here. I received no satisfactory explanation as to what would happen if funds from more than one source were used to effect payments under the same contract, only one of which was local authority funding. These difficulties do not arise if [section 49\(5\)](#) is treated as a provision which allows payments made by a maintained school to benefit from the authority's ability to recover VAT, without rendering the local authority the contracting party in all contracts entered into by the maintained school.

92. Finally, the effect of the construction advanced by the claimants and the College would be to expose local authorities to liabilities vastly in excess of the funding they had in fact allocated, or were legally liable to allocate, to maintained schools, it being the effect of Mr Oldham's submissions that any (presumably non de minimis) application of funds from the maintained school's designated budget under a contract rendered the local authority the principal under that contract, and liable for the full extent of any amounts due. This course would, as it seems to me, entirely subvert the regulatory system both for proper financial controls within education funding and the fair allocation of resources between different schools. While the maintained school may have authority to spend its delegated budget "as it sees fit" ([section 50 of the SSFA](#)), that is very far removed from it having the legal power to commit its local authority to liabilities vastly in excess of the amount of its delegated budget.

93. For these reasons, the construction of [section 49\(5\)](#) advanced by the claimants and the College is one which finds little support in the language of [section 49\(5\)](#) , and would give rise to insuperable practical difficulties in its application. Mr Oldham advanced five reasons why I should nonetheless adopt it.

94. The first was to seek to adduce evidence from Hansard as to the reasons why [section 49\(5\)](#) (which was then [clause 49\(7\) of the SSFA Bill](#)) came to assume the form it did. The evidence relied upon was a passage from the speech of Lord Whitty, a Lord-in-Waiting and a Government spokesperson in the House of Lords, when introducing the amendment, reported in Hansard (HL Debates) 4 June 1998, vol 590, cols 551–558. Mr Oldham in particular relied upon the passage at col 553 which provides:

"Finally, there are two further technical amendments ... These relate to clause 49(7), which provides that, in spending its delegated budget, the governors and heads of a maintained school are ordinarily deemed to be acting on behalf of the LEA. That is to say, they are in law acting as agents, not as principals. This is not intended to change the law. It frankly reflects what the department has always understood to be the legal position. However, for the avoidance of doubt, it seemed advisable to put this express provision in the Bill. One reason for that is that it removes any doubt as to whether VAT can properly be reclaimed by **1942* LEAs under [section 33 of the VAT Act](#) in respect of purchases made by schools from their delegated budgets and other funds provided by the LEA."

95. Lord Bingham of Cornhill in *R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd* [2001] 2 AC 349 , 391 specified three conditions for the admissibility of passages from Hansard as a guide to the interpretation of statutory materials: first, the legislation must be ambiguous, obscure or lead to an absurdity; second, the material relied upon must consist of one or more statements by a minister or other promoter of the Bill together, if necessary, with such other parliamentary material as might be necessary to understand such statements and their effect; and third, the effect of such statements must be clear. While the second of these conditions is satisfied, it is debatable whether the first condition is met, and the third most certainly is not. In particular, there is nothing in Lord Whitty's speech which addresses the status of contracts entered into by maintained schools, as opposed to the characterisation to be given (particularly for VAT purposes) to payments once they have been made. Accordingly, the passage from Hansard relied upon does not cause me to alter my preliminary interpretation of [section 49\(5\)](#) .

96. Second, Mr Oldham relied upon certain authorities which, he said, had adopted a clear and consistent interpretation of [section 49\(5\)](#) to the effect he contends for. The first is the decision of Underhill J in *Coventry City Council v Special Educational Needs and Disability Tribunal* [2008] ELR 1 (" *SENDIST* "), Administrative Court proceedings concerning a decision as to

whether the funding of a particular form of education for a child with dyslexia would involve an additional burden for the local authority. In rejecting the argument that there would be no such impact because the cost in question would not come from the local authority but from the delegated budget of a maintained school, Underhill J stated, at para 13:

“Mr Wolfe submits that those provisions [[section 49\(5\)](#)] show that notwithstanding the power given to the school to spend the money under the delegated arrangements, the expenditure remains ultimately that of the Council. In my view that submission is well-founded.”

97. It will be apparent that this decision was not addressing the identity of a contracting party at all, but making the practical point that, for the purposes of determining whether a particular form of education would involve an “additional burden ... on the LEA's annual budget”, there was no relevant distinction between funds which came directly from the local authority, and the use of funds which the local authority had placed into a maintained school's delegated budget.

98. The second decision is *EH v Kent County Council* [2011] LGR 798 . That case was concerned with essentially the same question as the *SENDIST* case—whether the distinction between local authority funding paid directly from its own pockets and that paid to maintained schools under delegated arrangements was relevant in considering whether a particular educational option involved an increased financial burden for the authority. At para 15, Sullivan LJ quoted the passage from Underhill J's judgment which I have set out above. At para 25 he noted that there could be said to be public expenditure both when a local authority allocated money to a *1943 maintained school's budget, and when that money is spent, and observed that it would be wrong to treat the dicta of Underhill J as “though they were enactments of general application, rather than responses to the particular circumstances” (para 26). I do not think that the decision lends any support to Mr Oldham's [section 49\(5\)](#) argument.

99. The third decision was *LS v Oxfordshire County Council* [2013] ELR 429 , a decision of the Upper Tribunal which was once again concerned with educational provision for a child with special needs. The issue for the Tribunal was the significance of the local authority's failure to tell the first instance tribunal of a pending change in the status of a school from a maintained school to an academy, which would have changed the nature of the school's funding. In the course of argument, it was noted that “under [section 49\(5\) of the \[SSFA\]](#) the local authority remains the owner of funds delegated to a maintained school and the governing body or head teacher simply acts as the authority's agent”, whereas academies received a grant from the Secretary of State for Education (para 54). Beyond noting the difference in the source of funding of maintained schools and academies, the Upper Tribunal did not otherwise discuss [section 49\(5\)](#) or consider what implications (if any) it had for contracts entered into by the school. In my view, this decision does not take matters further.

100. By contrast, I have found the decision of Zacaroli J in *Brent London Borough Council v Davies* [2018] EWHC 2214 (*Ch*) of real assistance. The case was concerned with the recovery of unlawful payments from members of the teaching and non-teaching staff of a maintained school. One of the grounds on which repayment was sought was that the payments had been made in breach of fiduciary duty, a case advanced on the basis that, by reason of [section 49\(5\)](#) , funds advanced by the local authority to the maintained school remained the property of the local authority until spent. In resisting this argument, the defendants contended that the agency created by [section 49\(5\)](#) was of a very limited kind, and one which did not give rise to fiduciary duties. In the course of the case, Zacaroli J was shown the same extract from Hansard which the College relies upon here. He concluded, at para 344:

“So far as [counsel for the first defendant's] reliance on the limited scope of the agency is concerned, *while I accept that there are significant differences between the deemed agency created by [section 49\(5\)](#) and the paradigm case of an agent, in that neither the [governing body] nor the headteacher is authorised to contract on behalf of the claimant and that once the money is spent any property acquired with it belongs absolutely to the school* , what remains is a clear statement that until the money is spent, property in it remains with the claimant, such that this is a case where the agent has the power to dispose of property belonging to the principal.” (Emphasis added.)

101. I accept that the reference to the agent's inability to contract on behalf of the local authority as principal is obiter, but it reflects what I have concluded is the proper interpretation of [section 49\(5\)](#) . Further, the fact that, as Zacaroli J noted, the statute provides for the local authority to have ownership of funds *before* they are spent, but not of any property acquired with those funds (a conclusion which the College did not challenge) is itself highly significant. It must be a very rare agent who

contracts on behalf of its **1944* principal, using its principal's funds to acquire property, but where property under the contract in question passes to and remains with the agent and not the principal.

102. Third, Mr Oldham suggests that it would not be possible to achieve the intended effect of the local authority being able to recover VAT on payments made by a maintained school under [section 33 of the Value Added Tax Act 1994](#) unless the payments in question are payments which the local authority is legally liable to make which, in the case of payments under a contract, entails that the local authority is the contracting party. I do not accept this argument. While that would ordinarily be the position when it comes to seeking a VAT rebate, in this case, the local authority does not need to establish its right to recover VAT as a matter of conventional contractual analysis because it has the benefit of a statutory deeming provision treating the payments, for VAT purposes, as payments it has made.

103. Fourth, Mr Oldham submitted that the [Accounts and Audit \(England\) Regulations 2011](#) (SI 2011/817), which required the Council to account for delegated budgets in its own accounts, would “be inexplicable unless the College’s interpretation of [section 49\(5\)](#) were correct”. However, the accounting regime which applies as between maintained schools and a local authority, and in particular the need for the latter to reflect spending from the schools’ delegated budgets in its own accounts, does not require the authority to be the contracting party in respect of contracts entered into by a school (any more than the consolidation of wholly-owned or controlled subsidiaries into group accounts has this effect).

104. Finally, Mr Oldham relies on the terms of the Secretary of State for Education's statutory guidance (*Schemes for Financing Schools, Statutory Guidance for Local Authorities* (December 2015) as to the content of local authority schemes for the funding of schools issued under [section 48](#) of the *SSFA* . Paragraph 2.11 of that guidance provides:

“Application of contracts to schools

“The scheme should contain a provision which makes clear the right of schools to opt out of authority arranged contracts.

“The scheme should include a provision which makes clear that although governing bodies are empowered under [paragraph 3 of Schedule 1 of the Education Act 2002](#) to enter into contracts, in most cases they do so on behalf of the authority as maintainer of the school and the owner of the funds in the budget share. (This is the main reason for allowing authorities to require authority counter-signature of contracts exceeding a certain value.)

“The provision should also however make it clear that other contracts may be made solely on behalf of the governing body, when the governing body has clear statutory obligations—for example, contracts made by aided or foundation schools for the employment of staff.”

105. In so far as the guidance was describing what might be the factual position in many cases, I have already explained why that factual position did not apply here. In so far as the guidance suggests that, as a matter of law, spending funds emanating from the local authority under a contract entered into by the school will have the effect of making the local authority, and not the school, the contracting party, I do not believe that this states the law correctly for the reasons I have set out above. **1945*

106. For all of these reasons, I reject the contention that the Council is a party to the Contract if the Contract is valid. Had I concluded otherwise, I would in any event have accepted Mr Daniel Stilitz QC's submission that payments under the Contract fell within one or both of the exceptions set out in [section 49\(6\)](#) to the deeming provision in [section 49\(5\)](#) . Given my conclusion reached below that the Contract involved borrowing because it was in the nature of a finance lease, it follows that payments under the Contract involve the repayment of borrowing under [section 49\(6\)\(a\)](#) , and, as a matter of the relevant accounting classification, that the expenditure under the Contract was in the nature of capital rather than operating expenditure under [section 49\(6\)\(b\)](#) (something Mr Jackson, the claimants’ accounting expert, confirmed in cross-examination would inevitably follow if the Contract was properly to be classified as a finance lease).

107. Mr Oldham's response to these points was to suggest that the Council's liability for a debt or damages due in respect of failure to repay a loan or to make a payment in respect of capital expenditure was (or might) be different in nature to its liability for the repayments under a loan or the incurring of capital expenditure itself because “the liability is, as I say, for debt and damages and not capital expenditure”. I found the argument that if the College had voluntarily repaid a loan or made a payment in respect of capital expenditure, [section 49\(6\)](#) applied, but if it refused to pay such that it became liable for an overdue debt or damages in an action, [section 49\(6\)](#) ceased to apply, wholly unpersuasive. The essential character of the obligation

does not change merely because it is necessary for the creditor to go to court to enforce it. It has been noted that “the essential nature and real foundation of a cause of action are not changed by recovering judgment upon it” (*Dicey, Morris & Collins on the Conflict of Laws* , 15th ed (2018), para 14-002), and the position of pre-judgment causes of action must be a fortiori. If Mr Oldham's argument was correct, the College would have a ready means of circumventing the [section 49\(6\)](#) restriction by refusing to repay any loans or pay for any capital expenditure voluntarily and requiring its creditors to commence court proceedings to recover their due.

108. Having established, therefore, that the putative contracting party is the College, not the Council, it is necessary to turn to the issue of whether the Contract is binding on the College.

The vires defence: the law

The problem stated

109. When determining the status of decisions of public bodies, administrative law once distinguished between unlawfulness “on the face of the record” which rendered a decision void, and unlawfulness within the exercise of powers, which rendered a decision voidable. That distinction was swept away by the decision of the House of Lords in *Anisminic Ltd v Foreign Compensation Commission* [1969] 2 AC 147 . At p 171, Lord Reid stated:

“It has sometimes been said that it is only where a tribunal acts without jurisdiction that its decision is a nullity. But in such cases the word ‘jurisdiction’ has been used in a very wide sense, and I have come to the conclusion that it is better not to use the term except in the narrow and original sense of the tribunal being entitled to enter on the inquiry in question. But there are many cases where, although the tribunal had **1946* jurisdiction to enter on the inquiry, it has done or failed to do something in the course of the inquiry which is of such a nature that its decision is a nullity. It may have given its decision in bad faith. It may have made a decision which it had no power to make. It may have failed in the course of the inquiry to comply with the requirements of natural justice. It may in perfect good faith have misconstrued the provisions giving it power to act so that it failed to deal with the question remitted to it and decided some question which was not remitted to it. It may have refused to take into account something which it was required to take into account. Or it may have based its decision on some matter which, under the provisions setting it up, it had no right to take into account. I do not intend this list to be exhaustive. But if it decides a question remitted to it for decision without committing any of these errors it is as much entitled to decide that question wrongly as it is to decide it rightly.”

110. Lord Dyson JSC in *R (WL (Congo)) v Secretary of State for the Home Department* [2012] 1 AC 245 , para 66 summarised the effect of *Anisminic* in the following terms:

“A purported lawful authority to detain may be impugned either because the defendant acted in excess of jurisdiction (in the narrow sense of jurisdiction) or because such jurisdiction was wrongly exercised. *Anisminic* ... establishes that both species of error render an executive act ultra vires, unlawful and a nullity. In the present context, there is in principle no difference between (i) a detention which is unlawful because there was no statutory power to detain and (ii) a detention which is unlawful because the decision to detain, although authorised by state, was made in breach of a rule of public law. For example, if the decision to detain is unreasonable in the *Wednesbury* sense, it is unlawful and a nullity. The importance of *Anisminic* is that it established that there was a single category of errors of law, all of which rendered a decision ultra vires ...”

111. The result is that, as a matter of public law, a decision of a public body may be void not simply because the body exceeded the letter of its powers, but also if the decision was taken for an improper purpose, or was substantively irrational (in the *Wednesbury* sense (*Associated Provincial Picture Houses Ltd v Wednesbury Corpn* [1948] 1 KB 223)), or because the decision was reached taking into account irrelevant considerations or failing to take into account relevant considerations, or because the process by which the decision was arrived at was unfair. Set against the wide range of grounds on the basis of which a decision of a public body might be found to be a nullity are various procedural protections embedded within the judicial review procedure for the benefit of those who have acted on the basis of a decision of a public body which, as Lord Radcliffe noted in *Smith v East Elloe Rural District Council* [1956] AC 736 , 769, “bears no brand of invalidity upon its forehead”. Those seeking to challenge the lawfulness of decisions of public bodies must bring their challenge promptly and, in the ordinary course, within

the three-month time limit provided by [CPR r 54.5](#) . They must obtain the court's permission under [CPR r 54.4](#) to bring the challenge. Finally, the court has a discretion as to whether, and in what form, to provide relief ([section 31 of the Senior Courts Act 1981](#) and, e g, *R v Inland Revenue Comrs, Ex p National Federation of Self-Employed and Small Businesses Ltd* [[1982](#)] *AC 617* , [*1947](#) 656), in the exercise of which the impact of relief on third parties is a relevant consideration.

112. Where, as in this case, the allegedly ultra vires nature of a public law decision is invoked by the public body itself as an answer to a private law claim asserted against it, the important public law policies of ensuring the legality and accountability of the decisions of public bodies, and the proper use of public funds, may come into conflict with the policies underlying the relevant field of private law. The law of contract (with its historical roots in the law merchant) has traditionally placed a premium on parties being able to rely on objective appearances when transacting (e g through the objective test for the conclusion and construction of contracts, the doctrine of ostensible authority and the various exceptions to the nemo dat principle). It regards the upholding of agreements intended to have legal force as a policy goal in its own right (a policy often expressed in the maxim *pacta sunt servanda*).

Public law defences to private law claims

113. It is clear that a public law error can be relied upon either to found, or to answer, a private law claim. In *Wandsworth London Borough Council v Winder* [[1985](#)] *AC 461* , a defendant to the council's claim for repossession of a council flat for non-payment of rent challenged the validity of the council's rent demand on public law grounds. The House of Lords rejected the suggestion that such an argument could only be deployed by way of a separate challenge for judicial review of the council's decision brought in compliance with the strictures of the then RSC Order 53, rather than by way of a defence to the council's private law claim.

114. *Winder* was a case in which the public authority had to rely upon the validity of its own public law decision setting the level of rent in order to establish its private law claim for contractual relief for the failure to pay rent when due. The tenancy in question had been granted under [Part V of the Housing Act 1957](#) , [section 113\(1A\)](#) of which (in combination with [section 40 of the Housing Act 1980](#)) gave the council a statutory public law power unilaterally to vary the level of rent during the tenancy. The council had purported to exercise that power to increase the rent, but the tenant disputed his liability to pay rent at the enhanced rate (while continuing to pay rent at the original level). In those circumstances, it is scarcely surprising that it was open to the tenant to contend, by way of defence, that the exercise of the power to increase his rent was a nullity as a matter of public law so that rent at the enhanced rate was not due.

115. In that respect there are similarities between *Winder* and the position in cases such as *R (WL (Congo)) v Secretary of State for the Home Department* [[2012](#)] *1 AC 245* and *R (Hemmati) v Secretary of State for the Home Department* [[2019](#)] *3 WLR 1156* , in which the claimants brought proceedings for the tort of false imprisonment, and where the only answer of the Home Secretary to such a claim was that she had validly exercised a public law power of detention. Once again, it is scarcely surprising that it was open to the claimant in a private law tort claim to contend that the public law decision to detain him was a nullity as a matter of public law. Similarly, in a case in which a claimant seeks to rely on a public law decision to found its private law claim against a public body (for example to recover a grant awarded by a public body in the exercise of public law powers which, [*1948](#) properly exercised, creates a statutory debt in the claimant's favour), it ought to be open to the public body to defend the claim on the basis that its decision was a nullity as a matter of public law so that no debt arose.

116. In the present case, the claimants' claims are founded on their private law rights of contract, and the defendants raise a private law defence to those claims, namely that they lacked the capacity to enter into the contract in question which, accordingly, is not binding. That defence is one which, if valid, operates as a matter of entitlement rather than discretion, and would have the effect in private law that the Contract was never binding upon any of the parties, regardless of when the point was first raised by the defendants and regardless of the consequences to the claimants or any third parties of the Contract being void. The issue which arises for determination is whether any public law ground of challenge to a decision to contract suffices to render the contract void ab initio as a matter of private law, or whether only some grounds of public law unlawfulness have this effect.

The decision in Crédit Suisse v Allerdale Borough Council

117. The first case to give detailed consideration to this issue was *Crédit Suisse v Allerdale Borough Council* [[1995](#)] *1 Lloyd's Rep 315* , in which a bank sought to recover a substantial sum pursuant to a guarantee which a local council had purported to execute in order to support a financing arrangement under which a limited company created by the council would build a

leisure pool and timeshare units. At first instance, Colman J found the council's decision to grant the guarantee to be a nullity as a matter of public law on three distinct and independently sufficient grounds:

- (i) The council had no statutory power to enter into the guarantee (“the lack of statutory power ground”).
- (ii) If the council had otherwise had statutory power to enter into the guarantee it did not have such power in this case because it was seeking to use the guarantee as part of a scheme to facilitate the doing by the company of things which the council itself had no power to do, namely (a) borrowing and spending amounts of money which exceeded its borrowing and spending limits and (b) carrying on a trade in timeshare accommodation for profit (“the improper purpose ground”).
- (iii) The decision of the council to enter into the guarantee was *Wednesbury* unreasonable because it was entered into when the council had given no or no proper consideration to the likelihood of having to pay under the guarantee and the consequences of any such payment (“the *Wednesbury* ground”).

118. It was argued before Colman J that while lack of statutory power would automatically have the result that the guarantee was outside the council's contractual capacity as a matter of private law, this was not so of the improper purpose or *Wednesbury* grounds. It was argued that, in respect of those grounds, it was first necessary to obtain an order quashing the decision to provide the guarantee in judicial review proceedings before they would provide a basis for defending a private law claim to enforce the guarantee. At p 351 Colman J rejected that argument:

“The reason why a transaction entered into beyond the powers of a public body is properly described as a nullity is because such a body has no *capacity* in law to act beyond the powers given to it by statute. Those **1949* powers comprehend not only what the subject matter of its decisions may be, but, by implication, *how* its decisions on the permissible subject matter should be taken.”

119. He further held (at pp 356–357) that the remedies available in a private law action where such lack of capacity was established were available as of right, and were not discretionary in the way that the remedies available in public law proceedings would be. Colman J held that the discretionary nature of relief in public law proceedings was a consequence of the terms in which the statutes empowering the court to grant such relief had been framed rather than something intrinsic to the nature of the invalidity established, and that those statutory provisions had no application when the issue arose in private law proceedings as a defence to a private law claim. Colman J did not regard that outcome as satisfactory, but concluded that it was for Parliament to provide a solution:

“Whatever the answer to that question, there is clearly a real and urgent need in the interests of the continuation of dealings between banks, credit providing institutions and local authorities for a solution to this problem to be found. Whether that solution should be one analogous to the principles which apply to third parties dealing with the directors of companies but in ignorance of their excess of actual authority, as identified in [*Rolled Steel Products (Holdings) Ltd v British Steel Corpn*] [1986] Ch 246 , or one which is based on the flexibility of remedy available in judicial review proceedings, or some other solution, may be a matter for debate, but, as English law on the exercise of powers by public bodies has now developed, it is certainly a matter for Parliament and not for the courts.”

120. In the Court of Appeal [1997] QB 306 there was a division of opinion on this issue between Neill and Hobhouse LJ (Peter Gibson LJ expressing no opinion), albeit the court's observations were obiter as Colman J's decision on the lack of statutory power ground was upheld.

121. Neill LJ and Hobhouse LJ referred to the important judgment of Browne-Wilkinson LJ which has brought a welcome clarity to the use of the concept of *ultra vires* in private law when dealing with the issue of corporate capacity in *Rolled Steel Products (Holdings) Ltd v British Steel Corpn* [1986] Ch 246 . Browne-Wilkinson LJ stated at pp 302–304:

“In my judgment, much of the confusion that has crept into the law flows from the use of the phrase ‘*ultra vires*’ in different senses in different contexts. The reconciliation of the authorities can only be achieved if one first defines the sense in which one is using the words ‘*ultra vires*’. Because the literal translation of the words is ‘beyond the powers’, there are many cases in which the words have been applied to transactions which, although within the capacity of the company, are carried out otherwise than through the correct exercise of the powers of the company by its officers; indeed, that is the sense in which the judge seems to have used the words in this case. For reasons which will appear, in my judgment, the use of the

phrase ‘ultra vires’ should be restricted to those cases where the transaction is beyond the capacity of the company and therefore wholly void. A company, being an artificial person, has no capacity to do anything outside the objects specified in *1950 its memorandum of association. If the transaction is outside the objects, in law it is wholly void. But the objects of a company and the powers conferred on a company to carry out those objects are two different things ... If the concept that a company cannot do anything which is not authorised by law had been pursued with ruthless logic, the result might have been reached that a company could not (ie had no capacity) to do anything otherwise than in *due* exercise of its powers. But such ruthless logic has not been pursued and it is clear that a transaction falling within the objects of the company is capable of conferring rights on third parties even though the transaction was an abuse of the powers of the company: see, for example, *In re David Payne & Co Ltd* [1904] 2 Ch 608 . It is therefore established that a company has capacity to carry out a transaction which falls within its objects even though carried out by the wrongful exercise of its powers.

“If the transaction is beyond the capacity of the company it is in any event a nullity and wholly void: whether or not the third party had notice of the invalidity, property transferred or money paid under such a transaction will be recoverable from the third party. If, on the other hand, the transaction (although in excess or abuse of powers) is within the capacity of the company, the position of the third party depends upon whether or not he had notice that the transaction was in excess or abuse of the powers of the company.”

122. Neill LJ considered whether, in the context of private law claims against public bodies,

“a distinction can be drawn, similar to that drawn in the *Rolled Steel Products* case ... between decisions and acts which are beyond the capacity of a public authority and decisions and acts which involve a misuse of power by those controlling the authority”: pp 339–340.

His answer was no (see pp 343–344):

“I know of no authority for the proposition that the ultra vires decisions of local authorities can be classified into categories of invalidity. I do not think that it is open to this court to introduce such a classification. Where a public authority acts outside its jurisdiction in any of the ways indicated by Lord Reid in *Anisminic Ltd v Foreign Compensation Commission* [1969] 2 AC 147 , 171 the decision is void. In the case of a decision to enter into a contract of guarantee the consequences in private law are those which flow where one of the parties to a contract lacks capacity. I see no escape from this conclusion. Furthermore this conclusion seems to me to accord with the decision of the House of Lords in *Wandsworth London Borough Council v Winder* [1985] AC 461 .”

“I do not consider the present law to be satisfactory. I say nothing about the merits of this case which have not been investigated. But there may be cases where it is beyond argument that a third party has entered into a contract with a public body in ignorance of any procedural defect which may later entitle the public body to claim that the contract was made ultra vires and so reject liability under it. But if, as I believe there to be, there is only one category of ultra vires decisions where a local authority is concerned I see no room for a judicial discretion.” *1951

123. Hobhouse LJ was of a different view. So far as the “no statutory power” ground was concerned, he noted that there was “no conflict between public law and private law principles” because

“the role of public law is to answer the question: what is the capacity of the local authority to contract? The role of private law is to answer the question: when one of the parties to a supposed contract lacks contractual capacity, does the supposed contract give rise to legal obligations?” (p 350).

He continued:

“When a plaintiff is asserting a private law right—a private law cause of action, typically a claim for damages for breach of contract or tort—the plaintiff must establish his cause of action. Any defence raised by the defendant must be one which is recognised by private law. Lack of capacity to contract is a defence recognised by private law.”

124. Hobhouse LJ held that the other grounds of invalidity raised by the council—the improper purpose and *Wednesbury* grounds—did not amount to a lack of capacity in private law, even if they constituted grounds of nullity in public law (pp 355–357):

“Before using the phrase ‘ultra vires’ or the words ‘void’ and ‘nullity’, it is necessary to pause and consider the breadth of the meaning which one is giving them. It is not correct to take terminology from administrative law and apply it without the necessary adjustment and refinement of meaning to private law. Where private law rights are concerned, as in the present case, the terminology must be used in the sense which is appropriate to private law ...

“Private law issues must be decided in accordance with the rules of private law. The broader and less rigorous rules of administrative law should not without adjustment be applied to the resolution of private law disputes in civil proceedings. Public law, that is to say, the law governing public law entities and their activities, is a primary source of the principles applied in administrative law proceedings. The decisions of such entities are the normal subject matter of applications for judicial review. When the activities of a public law body, or individual, are relevant to a private law dispute in civil proceedings, public law may in a similar way provide answers which are relevant to the resolution of the private law issue. But after taking into account the applicable public law, the civil proceedings have to be decided as a matter of private law. The issue does not become an administrative law issue; administrative law remedies are irrelevant.”

At p 357 he concluded:

“It remains necessary to ask what amounts to a defence to a private law cause of action. Want of capacity is a defence to a contractual claim; breach of duty, fiduciary or otherwise, may be a defence depending upon the circumstances.”

125. Mr Stilitz for the Council argued that Hobhouse LJ's analysis “founders on the clear words” of Lord Diplock in *F Hoffmann-la Roche & Co AG v Secretary of State for Trade and Industry* [1975] AC 295 , *1952 365 where he stated:

“It would, however, be inconsistent with the doctrine of ultra vires as it has been developed in English law as a means of controlling abuse of power by the executive arm of government if the judgment of a court in proceedings properly constituted that a statutory instrument was ultra vires were to have any lesser consequence in law than to render the instrument incapable of ever having had any legal effect upon the rights or duties of the parties to the proceedings.”

126. However, that case was concerned with the status of delegated legislation, the enactment of which is an inherently public law activity, and the binding effect of which depends entirely on the valid exercise of the public law power to pass delegated legislation. *Hoffmann-la Roche* did not consider the status of a private law contract which a public body enters into pursuant to an internal decision which could be impugned on public law grounds, and which had then sought to resist a claim in contract by reference to the private law defence of lack of contractual capacity. In private law, it is the act of contracting itself, not the decision of a putative contracting party to enter into a contract, which is legally significant. If public law unlawfulness is to provide an answer to a claim in contract, it must be because of the effect of that unlawfulness on the legal act of concluding the contract.

127. The rival views of Neill and Hobhouse LJ have each attracted judicial support in subsequent case law, but the conflict remains essentially unresolved.

128. In *Bedfordshire County Council v Fitzpatrick Contractors Ltd* [2001] LGR 397 , 407 Dyson J stated that it was not clear to him “to what extent in practice the approaches of Hobhouse LJ and Neill LJ differ, but to the extent that they differ” he found “the reasoning of Neill LJ more compelling”.

129. In *Charles Terence Estates Ltd v Cornwall Council* [2012] PTSR 790; [2013] PTSR 175 Cornwall Council was sued as the statutory successor to Penwith and Restormel Borough Councils. Cranston J at first instance found that the councils had taken out leases in breach of their *Roberts v Hopwood* public law duty (*Roberts v Hopwood* [1925] AC 578). The issue then arose

of whether the councils could rely upon that breach as a defence to a claim in private law for the rent. Cranston J suggested that bad faith, improper motive or a breach of the *Roberts v Hopwood* duty on the part of a public body entering into a contract would all give rise to a lack of capacity as a matter of private law, but not “failure to act for, or take account of, a non-statutory purpose or consideration” or “making a contract in breach of internal rules and procedures” ([2012] PTSR 790, para 64).

130. The Court of Appeal reached a different conclusion on the issue of whether the *Roberts v Hopwood* duty had been breached, with the result that its observations on the effect of such a breach on the council's capacity to contract were obiter. Maurice Kay LJ at [2013] PTSR 175, para 37 held:

“In my judgment, the approach of Hobhouse LJ is to be preferred. I do not think that the assimilation of the various types of public law error in the *Anisminic case [1969] 2 AC 147* had the effect of imposing a rule which extends inexorably to public law error as a defence to a private law claim. There is no logical reason why it should and this *1953 case demonstrates why it should not. It would be highly undesirable if, years after time expired for the making of a prompt public law challenge by a person with a sufficient interest, the fact of a historic breach of fiduciary duty should inevitably lead to the defeat of a private law claim brought by a party who acted throughout in good faith. The *Crédit Suisse* case was a clear case of lack of legal capacity. Here, however, Penwith and Restormel were doing what they were empowered to do by section 17(1)(b) of the 1985 Act in order to meet their onerous statutory duties. I would respectfully adopt the words of Hobhouse LJ [1997] QB 306, 357D: ‘breach of duty, fiduciary or otherwise, may be a defence depending on the circumstances.’ I am satisfied that the breaches in this case (if there were any) simply did not go to legal capacity. At some point, it will be desirable for there to be judicial consideration of the territory between the extremes of the *Crédit Suisse* case and the present case. I have come to the conclusion that we have not heard sufficient argument to enable us to articulate more comprehensive guidance.”

131. Etherton LJ expressed a similar view at paras 44–47:

“44. ... There was much debate before us, however, on the wider point of principle about the relationship between private law and public law concepts of ultra vires.

“45. In my view, the principled approach to that issue is clear. If a transaction is beyond the capacity of a statutory corporation, it is void: that is, it was always a nullity.

“46. A corporation can only act by its agents. If its agent enters into a transaction with a third party which is beyond the agent's actual or apparent authority, the transaction is a nullity since the act of the agent was never binding on the corporation. Apparent authority depends upon whether the principal made a representation to the third party about the agent's authority and whether the third party had knowledge of any limitation on the existence or scope of that authority.

“47. If the transaction with the third party was within the capacity of the statutory corporation and was within the actual or apparent authority of its agent, then, even if the transaction was a breach of duty by the corporation or by its agent, the transaction is not void. Depending on the facts, the corporation may have legal or equitable rights against the third party, such as for mistake, unjust enrichment or as a constructive trustee, but the transaction itself is not a nullity.”

132. Referring to the “critical distinction” as a matter of private law between acts done in excess of the capacity of a company on the one hand and an act done in excess or abuse of the powers of the company on the other, he continued at para 49:

“I can see no sound reason why the position should be any different where what is in issue is the validity of a commercial private law transaction between a corporation which is a public body and a third party. The existence of public law remedies for breach of public law duties should make no difference to the private law consequences of ultra vires (want of capacity), on the one hand, and breach of duty in respect of a transaction within the capacity of the corporation, on the other hand.”
*1954

At para 51, he too indicated his preference for the reasoning of Hobhouse LJ over that of Neill LJ in *Crédit Suisse* .

133. In *Pro-Vision Systems (UK) Ltd v United Lincolnshire Hospital NHS Trust (unreported) 21 February 2014*, Judge Waksman QC, in a passage which was once again obiter, held at para 176:

“As to the law, for myself I will adopt the views expressed by Etherton LJ in the *Charles Terence Estates* case, such that a rigid demarcation should be maintained between (a) a public law challenge to a public body decision to enter into a contract; (b) the scope of any private law defence to a claim to enforce it so that the ability to allege something short of pure ultra vires, for example, actual incapacity, must at best be very exceptional. On that footing the allegations made here must surely fall on the wrong side of the line, even if true. Although Maurice Kay LJ may have left the point slightly more open, I have no doubt he would have taken the same view on the facts of this case.”

134. However, the observations in the case, and the view of Hobhouse LJ, do not find support in the current edition of *Chitty on Contracts*, 33rd ed (2019), para 11-038.

The cases on “irrationally generous” payments

135. There are a number of decisions in private law litigation to enforce contracts entered into by local authorities with their employees which were said to be inappropriately generous, in which the courts have generally proceeded on the assumption that if a decision by a public body to enter into a contract can be impugned on any ground of public law, there is no binding contract as a matter of private law.

136. The first is *Newbold v Leicester City Council [1999] ICR 1182* in which street cleaning drivers employed by the council sued for breach of contract, when the council refused to implement the agreed payment of lump sum bonuses in return for a variation in the terms of employment (after receiving advice that the payments might be vulnerable to challenge). The Court of Appeal refused to uphold the *Wednesbury* challenge on the facts. It appears to have been common ground, and the court certainly assumed, that if the challenge had been upheld, this would necessarily have entailed that the agreement to pay the bonuses was void.

137. However, Simon Brown LJ made some pertinent observations on the ability of a public body to pray in aid its own public law unlawfulness in answer to a claim under a contract it had entered into. At p 1190, he noted that “it appears at first blush a remarkable proposition that a public authority can escape what on its face is a clear contractual liability to employees by asserting that the contract in question ... was excessively generous ... and thus outside its powers”. He distinguished *Allsop v North Tyneside Metropolitan Borough Council [1992] ICR 639* (discussed below) and *Hazell v Hammersmith and Fulham London Borough Council [1992] 2 AC 1* as cases involving proceedings by local authority auditors against the council for rectification of the councils’ accounts under section 19 of the Local Government Act 1982. At p 1191, he described *Hazell* as a case “concerned only with the legality of the contracts in the public law sphere *1955 [which] did not deal with the consequences to third parties of illegality”, and stated that: “It is arguable that the principle that ultra vires contracts are void and unenforceable does not apply in relation to public authorities ...”

138. Whatever the true position, he suggested that:

“one may safely assume that no court is going to be astute to allow public authorities to escape too easily from their commercial commitments. That should particularly be the case where, as here, legitimate expectations have been aroused in the other party (who clearly entered the contract in good faith), where the relationship between the parties is essentially of a private law character, where it is the authority itself which is seeking to assert and pray in aid its own lack of vires, and where that lack of vires is suggested to result not from the true construction of its statutory powers but rather from its own *Wednesbury* irrationality. The burden upon the authority in such a case must be a heavy one indeed. It does not seem to me that the council came within measurable distance of discharging it here.”

139. If, however, *any* ground of public law unlawfulness in a decision to contract deprives a public body of contractual capacity, it is difficult to see how there can be a heavier burden in establishing *Wednesbury* unreasonableness when it has private law as opposed to public law consequences, or why it would matter that the lack of vires rested on *Wednesbury* unreasonableness rather than the absence of a statutory power.

140. The second decision is *Hinckley and Bosworth Borough Council v Shaw* [2000] LGR 9 , in which a local authority agreed to increase the final year's salary of an employee specifically for the purpose of enhancing the employee's redundancy and pension entitlements. That decision was taken against the background of the Court of Appeal's decision in *Allsop v North Tyneside MBC* [1992] ICR 639 holding, as a matter of statutory construction, that a council did not have the power to make redundancy payments exceeding those it was obliged to make under section 81 of the Employment Protection (Consolidation) Act 1978 . Hinckley council's decision to increase Mr Shaw's salary was an attempt (to which Mr Shaw was a knowing party) to effect indirectly the payment of higher redundancy payments which (on the basis of the *Allsop* decision) the council had no power to pay directly.

141. Bell J held that the agreement between the council and Mr Shaw was beyond the powers of the council and not binding because it had been made “for the extraneous or collateral purpose of increasing the employee's redundancy or retirement benefits beyond what the Acts and regulations would allow, but for the increase in pay” (at p 40). Bell J rooted the unlawfulness in question in the *Roberts v Hopwood* principle. *Allerdale* [1995] 1 Lloyd's Rep 315; [1997] QB 306 was not cited. Given Mr Shaw's knowledge of the council's improper purpose in varying his contract, it seems likely that the same outcome would have followed whether Neill LJ or Hobhouse LJ's view in *Allerdale* was adopted. The decision could also be explained on the basis that a decision taken with the improper purpose of evading a statutory limit on a council's powers has the same status in private law as a decision taken outside of those powers. It may be for this reason that Laws LJ in *Gibb v Maidstone & Tunbridge Wells NHS Trust* [2010] IRLR 786 , para 7 referred to *Hinckley* and another similar case, *Eastbourne Borough Council v Foster* (unreported) 20 December 2000 *1956 (Colin Mackay QC), as “instances where a local authority unlawfully sought to set in place arrangements which would allow it to make payments above a permitted statutory maximum”.

142. The final decision is *Gibb v Maidstone & Tunbridge Wells NHS Trust* [2010] IRLR 786 , a case in which a National Health Service Trust sought to resist a private law claim by its former chief executive for payment of the amounts due under a compensation agreement the Trust had entered into, on the basis that the agreement was “irrationally generous” and hence ultra vires as a matter of public law. It appears to have been common ground in the case that the Trust lacked contractual capacity, as a matter of private law, to agree to make “irrationally generous” payments (para 4). Laws LJ was clearly unattracted by the Trust's contention, suggesting that it had “a very steep hill to climb” (para 7). The court overturned the finding that the payments were irrationally generous, and did not address the issue of whether such a finding led inexorably to a lack of contracting capacity.

The Administrative Court decisions

143. There have also been a number of decisions in the Administrative Court which have addressed the consequences of public law invalidity so far as the decisions by public bodies to enter into contracts were concerned, often in a situation where the decision of the public body to enter into a contract with one entity was challenged by another, who contended that the procurement or tender process was unlawful or unfair.

144. In *R (Structadene Ltd) v Hackney London Borough Council* [2001] 2 All ER 225 the local authority refused to accept an offer to purchase a number of industrial units from the applicant, and entered into a contract of sale with the existing tenants on less advantageous terms. The applicant obtained permission to apply for judicial review, alleging that the sales involved a breach of section 123(2) of the Local Government Act 1972 , being a sale of land for other than the best price without the Secretary of State's permission, as well as being independently unlawful on *Roberts v Hopwood* and *Wednesbury* grounds. Section 128(2) of that Act contained a saving for transactions entered into without ministerial consent with innocent third parties, but that saving was held to apply only if the contracts had proceeded to completion (which the contracts with the tenants had not). Elias J held that section 128(2) did not apply to the other heads of public law unlawfulness in any event. He found that the applicant was entitled to have the contract with the tenants declared invalid, but there was no discussion of whether this outcome followed inexorably as a matter of private law from the invalidity of the council's decision on public law grounds, or took the form of discretionary relief afforded in public law.

145. *R (Transport and General Workers Union) v Walsall Metropolitan Borough Council* [2002] ELR 329 was a case in which a trade union whose members worked in the defendant council's catering department successfully challenged the council's decision to award the contract for catering services to an outside contractor in judicial review proceedings. It is clear from Harrison J's judgment that he did not regard the fact that the procurement decision was unlawful as automatically entailing that the contract with the outside caterer was void, and that the decision whether or not to declare the contract void was a matter of discretion. At para 43, he accepted that “he had a broad *1957 discretion in deciding whether or not [he] should grant relief”,

but he decided in the circumstances that it was appropriate to grant relief not least because the evidence showed that the council and the outside caterer “went into it with their eyes open” (para 45).

146. The next decision I was referred to was *London & South Eastern Railway Ltd v British Transport Police Authority* [2009] *Po LR 157*. The facts of the case are complicated, but in short the defendant (“the BTA”) was a public body set up to maintain the British Transport Police, and to recover the costs of doing so from users of the rail network (the train operating companies “TOCs”). Each TOC entered into an agreement with the BTA known as a police services agreement or “PSA”. The BTA sought to change the amounts payable under the PSAs in a way which advantaged some TOCs and disadvantaged others, leading to an application for a judicial review by the disadvantaged TOCs. Collins J held that the BTA did not have the power to vary the amounts payable by the disadvantaged TOCs, and accordingly that the amounts for which they had been invoiced were not due. However, the advantaged TOCs contended that they had agreed their more favourable terms with the BTA as a matter of contract, and that the status of their contracts was not affected by the public law unlawfulness established by the disadvantaged TOCs.

147. The court held that if there was any such agreement, it was “tainted with the illegality” of charging the disadvantaged TOCs more (para 46) and that the favourable contracts had, in *Wednesbury* terms, been entered into following a failure to have regard to a material consideration. At paras 47–48, Collins J stated:

“47. Mr Fordham submitted that such unlawfulness could not affect contractual obligations entered into by the Authority if the effect would be to the detriment of the other party. He recognised that contracts which were entered into by public bodies which were ultra vires were void and so their terms were unenforceable against or by the public body ... Mr Fordham submitted that it was only if the public body had exceeded its lawful powers that a contract could be declared to be of no effect.

“48. I see no good reason for the suggested limitation. An irrational act (to use the term as defined by Lord Diplock in [*Council of Civil Service Unions v Minister for the Civil Service* [1985] *AC 374*]) is unlawful and so if that act is the entering into of a contract that contract cannot be valid. The usual public law requirement that action is taken to set aside the contracts within at most three months will prevail, but, following the principles laid down by the House of Lords in *Wandsworth London Borough Council v Winder* [1985] *AC 461*, it would be possible for a party to raise the unlawfulness as a defence to a claim based on the contract. Mr Fordham has to recognise that in *R (Transport and General Workers Union) v Walsall Metropolitan Borough Council* [2002] *ELR 327* a decision to enter into a contract was quashed and the contract declared void and of no effect because of procedural improprieties in the decision. It follows that the variation in favour of NMF cannot be valid.”

Collins J considered, but rejected, a submission by the advantaged TOCs that he should refuse relief as a matter of discretion
***1958**

148. Finally, it is worth noting the observations of the Privy Council in *Central Tenders Board v White* [2015] *BLR 727*. In that case, the Central Tenders Board of Monserrat raised an ultra vires defence to a claim to enforce a contract for the construction of a school hall which the Board had awarded to Mr White. The Privy Council rejected the suggestion that the contract was ultra vires the Board. They noted, at para 26:

“Ultra vires is not, of course, the only ground on which a court may quash an administrative decision, but it would be wrong for a court to do so in such a way as to nullify a contract made between a public body pursuant to a legal power and a person acting in good faith, except possibly on terms which adequately protect that person's interest.”

149. Those observations lend some support to the suggestion that, even in public law proceedings, it may be appropriate to distinguish between different grounds of public law unlawfulness when determining whether and on what terms to grant a discretionary remedy which would impact on a third party which has contracted with the public body in good faith.

Analysis and conclusion

150. It is clear that if a public body lacks statutory power to enter into a contract of a particular kind, then it will not have contractual capacity to do so as a matter of private law. As Hobhouse LJ noted, public law (through the construction of the

statutory regime) answers the question “what is the capacity of the public body to contract?”, and then private law provides that the consequence of that lack of capacity is that no contract comes into existence.

151. The difficulty comes when addressing cases in which the public body has capacity to enter into a contract of a particular kind, but the way in which it has taken the decision to do so can be impugned on public law grounds. The authorities offer conflicting views on that issue, and provide no answer which is binding on a first instance judge. In these circumstances, it is necessary to approach the issue from first principles.

152. So approached, if the nullity of a public body's decision to conclude a contract as a matter of public law was determinative of the status of the contract for all purposes as a matter of private law, then the same consequences ought automatically to follow from establishing that nullity, whether this occurs in public or private law proceedings.

153. However, this is not the case. In Professor Burrows QC's terminology (“We Do This At Common Law But That In Equity” (2002) 22 OJLS 1), we may do this in private law, but we do that in public law. In public law, the grounds for impugning a decision to contract may (in Hobhouse LJ's words) be “broader and less rigorous”, but obtaining relief on the basis of those grounds is subject to a heightened obligation of diligence in bringing a challenge promptly, and relief is discretionary and can be withheld on various grounds intended to avoid injustice to the defendant or third parties. The approach more closely resembles the legal method of equity than that of the common law.

154. Thus, in public law proceedings, it is clear that the court may refuse to grant relief declaring a contract to be invalid as a matter of discretion, and that one consideration which may well weigh strongly in a decision to do so is **1959* whether the contract was entered into with a person acting in good faith who would be prejudiced by the declaration of invalidity, particularly where there has been delay in bringing the challenge. For this reason, a party seeking to challenge a public law decision which involves the entry into a contract with a third party will sometimes seek an injunction to prevent such a contract going ahead at all, or allow it to proceed only if a term is included which cancels the contract if the public law challenge succeeds (as in *R v Hammersmith and Fulham London Borough Council, Ex p Beddowes [1987] QB 1050*).

155. It would appear to be implicit in a decision to refuse such relief as a matter of discretion in public law proceedings that the court is acting to protect the private law rights and entitlements of the party who had contracted in good faith. That motivation is sometimes expressly articulated (eg in *Central Tenders Board v White [2015] BLR 727*). If the nullity of the decision to contract as a matter of public law necessarily and inevitably entailed the invalidity of the contract as a matter of private law, there would be no third party interest for the court to seek to protect when deciding what discretionary relief to grant. In any event, any attempt to protect such an interest would be in vain, because whatever relief was or was not ordered in the public law proceedings, the invalidity of the contract as a matter of private law would have been definitively established and would remain for all time. In short, the public law decisions appear to acknowledge, at least to some extent, a legitimate interest in protecting those who have acted on the basis of the apparent validity of a contract and in protecting settled states of affairs which would be entirely undermined by a wholesale transportation of the scope of public law unlawfulness into the private law issue of contractual capacity. This difficulty strongly suggests that the nullity, as a matter of public law, of a decision to contract does not, without more, equate to a lack of contracting capacity as a matter of private law.

156. Further support for the view that public law invalidity and private law incapacity are not co-extensive can be derived from the fact that the taking of an ultra vires point in private law proceedings is not subject to any of the procedural safeguards which apply in public law proceedings. I am conscious that this argument has strong echoes of the submission advanced by Mr Michael Beloff QC but rejected by the Supreme Court in *R (WL (Congo)) v Secretary of State for the Home Department [2012] 1 AC 245*. At para 67, Mr Beloff submitted that it should not be open to Mr Lumba, when advancing his claim for damages for false imprisonment, to impugn the decision relied upon as the basis for his detention on public law grounds because this would involve “a private law action without any of the procedural safeguards which apply in a judicial review application” such as the tight time limit for bringing claims and the discretionary nature of relief. That argument was rejected by Lord Dyson JSC at para 70, who stated:

“As for Mr Beloff's other points, such force as they have derives from the fact that the detention in these cases is unlawful because it is vitiated by a public law error. The significance and effect of that error cannot be affected by the fortuity that it is also possible for a victim to challenge the decision by judicial review proceedings (which are subject to tighter time limits than private law causes of action) and that judicial review is a discretionary remedy. It is well established that a defendant can rely on a public law error as a defence to civil proceedings and that he **1960* does not need to obtain judicial review as a condition for defending the proceedings: see, for example, *Wandsworth London Borough Council v Winder [1985] AC 461*. The same applies in the context of criminal proceedings: see *Boddington v British Transport Police [1999] 2 AC*

143 . Mr Beloff submits that the position of a claimant who relies on a public law error to found his cause of action and a defendant can sensibly be differentiated. But it is difficult to see how or why.”

157. However, as I have noted, *R (WL (Congo)) v Secretary of State for the Home Department* was a case in which the public body was, in effect, deploying an exercise of its own public law powers to justify conduct (detaining Mr Lumba) which, in the absence of the lawful exercise of public law powers, was tortious. Adapting Hobhouse LJ's analysis in *Allerdale [1997] QB 306* , public law answered the question “was the imposition of a constraint on Mr Lumba's freedom of movement lawful?” (it being a necessary ingredient of the private law tort of false imprisonment that it was not), and private law answered the question, “what are the consequences if it was not?” (the tort of false imprisonment is committed).

158. Finally, in a private law context, a test for contractual capacity which was essentially the same for private and public law bodies might be thought a better fit with English law's traditional sensitivity on the issue of whether public bodies should be legally privileged in their dealings with private bodies, save where a differential treatment is mandated by statute or well-established prerogative powers (see e g Dicey's second aspect of the rule of law, namely “the equal subjection of all classes to the ordinary law of the land administered by the ordinary law courts”: *Introduction to the Study of the Law of the Constitution* 8th ed (1915), p 120). The fact that for companies, the legislative intervention of sections 39–42 of the Companies Act has altered the consequences of ultra vires for one species of private law legal persons, just as the [Local Government \(Contracts\) Act 1997](#) has altered the consequences of an ultra vires contract for a certain class of public body where certain requirements are met, does not itself provide a basis for applying a different common law test of what constitutes lack of contractual capacity for private and public law entities (cf the criticism of *Charles Terence Estates [2013] 1 WLR 466* advanced in *Chitty* , para 11-038).

159. In the present case, the claimants are bringing a private law claim in contract, to which the defendants' private law answer is that the contract is not binding. In this context, the analysis which best addresses the competing tensions and policy considerations is that proposed (obiter) by Hobhouse LJ in *Crédit Suisse [1997] QB 306* and endorsed (obiter) by the Court of Appeal in *Charles Terence Estates* by effectively allowing public law unlawfulness to provide a defence to a private law claim in contract when the facts which give rise to that public law unlawfulness also give rise to a private law defence. Thus a contract will be void if a public body lacked power to enter into a contract of that type, in the same way as a contract entered into by a private statutory corporation would be void, absent (in each case) the effect of saving legislation. In such a case, the public law lack of power provides the basis for the private law defence of lack of capacity. Where the public body in question has the power to enter into a contract of the relevant kind, but the exercise of that power is unlawful on public law grounds (for example because the exercise is for an improper purpose or is unreasonable *1961 in the *Wednesbury* sense), then it will be necessary for the facts giving rising to the public law unlawfulness to provide a basis for impugning the contract recognised in private law. This might be because the body's power to enter into contracts has been abused, in which case (adopting the words of Brown-Wilkinson LJ in *Rolled Steel [1986] Ch 246*) “the position of the third party depends on whether or not he had notice that the transaction was in excess or abuse of the powers”. It is suggested that this is what Hobhouse LJ had in mind in *Allerdale* when stating at p 357 that “breach of duty, fiduciary or otherwise, may be a defence *depending upon the circumstances* ” (emphasis added).

160. It is right to note that this distinction between the private law consequences of an absence of a public law power to enter into a contract of the relevant kind (no capacity) and a case where the power has been exercised in breach of public law duties (breach of duty) comes under particular strain when the abuse of power in question arises from it being exercised with the improper purpose of seeking to do indirectly that which there is no power to do directly. In *Allerdale* , for example, the improper purpose finding was made by Colman J (p 323) on the basis that:

“If the council would otherwise have statutory power to enter into the guarantee it did not have such power in this case because it was purporting to use the guarantee as part of a scheme to facilitate the doing by the company of things which the council itself had no power to do.”

161. Similarly, many of the “irrationally generous” payment cases involved attempts to circumvent the lack of any statutory power to pay redundancy other than at the approved or specified levels. It might be said that there is something unsatisfactory in there being different private law consequences to a contract entered into which the council did not have power to conclude, and a contract entered into for purpose of circumventing the lack of such a power. If, properly construed, the contractual disability

resulting from the lack of statutory power extends to the circumventing acts as well as those directly prohibited, then there is no difficulty in classifying both as involving lack of contractual capacity as a matter of private law. It may be for this reason that in *Allerdale [1997] QB 306* Neill LJ referred to the improper purpose point as raising “questions which are similar to those which I have already considered under section 111 [ie the statutory power point]” (p 333), and note also Laws LJ’s comment in *Gibb v Maidstone & Tunbridge Wells NHS Trust [2010] IRLR 786*, para 7 quoted above. Alternatively, in those cases where the public body and the payee have worked together to structure the contract in an attempt to circumvent a statutory control, the requirement of notice before an abuse of a power argument will avail against a third party in private law is likely to be met.

162. In summary, therefore, I have concluded that a decision by the College to enter into a contract which the College did not have power to conclude would give rise to a private law defence of lack of contracting capacity. If, however, the College did have power to enter into contracts of the relevant type, but is alleged to have acted unlawfully in reaching its decision to contract, the consequence of such public law unlawfulness in private law will depend both on the nature of the unlawfulness, and on whether the counterparty had notice of the relevant breach of public law duty. *1962

The vires defence based on borrowing

163. The College and the Council advanced a number of grounds on which it was said that the Contract was void. However, their principal ground of attack, and the issue which consumed most time at the hearing, was the contention that the Contract was void because it involved borrowing for the purposes of the *Education Act 2002, Schedule 1, paragraphs 3(3)(a) and (4)(a)*, for which the Secretary of State’s permission had not been obtained.

The parties’ submissions

164. The defendants’ case can be summarised in three propositions: (i) the Contract was a “finance lease” under the relevant applicable accounting standard; (ii) as such it amounted to “borrowing” within the meaning of paragraphs 3(3)(a) and (4)(a) of *Schedule 1* to the 2002 Act; and (iii) in the absence of the Secretary of State’s consent to such borrowing, it was beyond the College’s capacity to enter into the Contract.

165. Mr Timothy Straker QC, on behalf of the claimants, denied that it was unlawful for the College to enter into the Contract on the basis of five alternative submissions.

166. First, he contended that on a proper construction of the 2002 Act, paragraphs 3(1) and 3(3)(a) granted a power to the College to borrow, the scope of which was not limited by paragraph 3(4)(a) which merely regulated the manner in which that power was to be exercised. He contends that while exercising the power conferred by paragraph 3(3)(a) without the Secretary of State’s consent might be in some sense be open to criticism, it would be *intra vires* (“the paragraph 3(1) and 3(3)(a) Argument”).

167. Second, Mr Straker contended that even if paragraph 3(4)(a) does impose a limit on paragraphs 3(1) and 3(3)(a) of the 2002 Act, that limit was not engaged here. He submitted that paragraph 3(4)(a) only requires the Secretary of State’s consent in respect of a transaction which involves borrowing *and* the grant of security in conjunction (“the Security Argument”).

168. Third, it was Mr Straker’s case that the Contract did not in any event involve “borrowing” within the meaning to be accorded to that word in paragraph 3(4)(a). He submitted that the ordinary meaning of the word “borrowing” does not extend to a transaction such as the Contract, as evidenced by the fact that no one contemporaneously or for years after the Contract was entered into suggested that the Contract involved borrowing. As the Contract did not amount to borrowing as a matter of ordinary language, Mr Straker submitted that the technical question of whether the Contract was an operating or finance lease was not relevant (“the *Cozens v Brutus* Argument” (see para 176 below)).

169. Fourth, as a variation of the argument in the preceding paragraph, Mr Straker submitted that paragraph 3(4)(a) was only engaged when a school borrowed “such sums” as it saw fit. In this case no sums were ever identified by the College as the sums to be borrowed, so the College cannot have needed to obtain the Secretary of State’s consent (“the Such Sum Argument”).

170. Fifth, and finally, Mr Straker contended even if a finance lease would involve borrowing within the meaning of paragraph 3(4)(a), the Contract was an operating lease and not a finance lease. *1963

Issues as to the interpretation of the Education Act 2002, Schedule 1, paragraphs 3(1), (3) and(4)(a)

171. The first four submissions of the claimants raise issues which are matters of statutory interpretation and if any one of those arguments succeeds, it would be unnecessary to consider the factual question of whether the Contract is a finance lease. Given the threshold nature of these questions, I consider them first.

The paragraph 3(1) and 3(3)(a) Argument

172. In my view it is clear that paragraph 3(4)(a) imposed a statutory condition precedent to the power of a governing body to borrowing money, namely obtaining the consent of the Secretary of State:

- (i) Paragraph 3(1) gave the College power to “do anything which appears to them to be necessary or expedient for the purposes of, or in connection with, the conduct of the school”. However, as a matter of statutory interpretation, that power is subject to the limitations appearing elsewhere in the same Schedule.
- (ii) Paragraph 3(3)(a) identifies specific powers within paragraph 3(1), including “to borrow such sums as the governing body think fit”. However, subject to the further arguments I will come to, this was a power to borrow with the written consent of the Secretary of State rather than a general power to borrow. It is not possible to construe paragraph 3(1) as conferring a power on the College untrammelled by the requirement for obtaining written consent for borrowing under paragraph 3(4)(a). This would render the limitation imposed by paragraph 3(4)(a) entirely nugatory. It would seem to follow from Mr Straker's argument that the limitation on the power to contract in paragraph 3(7) would be similarly nugatory because that limit would not impact the width of the power afforded by paragraph 3(1).
- (iii) The correct approach is to construe [Schedule 1](#) as a whole giving proper weight to all its parts. Doing so, it is clear that paragraphs 3(4)(a) and 3(7) limit the powers afforded to the College by paragraph 3(1) and illustrated in paragraph 3(3).

173. Mr Straker's second argument was that paragraph 3(4)(a) did not limit the College's power to borrow, but imposed a requirement as to the manner of its exercise. Once again, I am unable to accept this argument:

- (i) Paragraph 3(4)(a) provides that the power “may *only* be exercised” (emphasis added) with the Secretary of State's consent. This language strongly suggests that paragraph 3(4)(a) was imposing a limit on the power mentioned in 3(3)(a) (as conferred by paragraph 3(1)).
- (ii) Not only is this the natural construction as a matter of language, it is also supported by authority. In *Rhyl Urban District Council v Rhyl Amusements Ltd [1959] 1 WLR 465* Harman J considered the effect of [section 177 of the Public Health Act 1875](#) which provided that “any local authority may, with the consent of the local government board, let for any term any lands which they possess”. The council did not obtain the relevant consent. Harman J held at pp 473–474 that “the only power of letting” which the council had was with the consent of the Ministry of Health and “if, therefore, the consent of that body was not obtained, the lease was, in my opinion, ultra vires and void”. At p 475, he rejected the argument that “the present was not a case of the plaintiff council having no power, but that **1964* they had a power if they obtained the necessary consent” as “a quibble”. In my view, Mr Straker's attempt to distinguish the wording in that case from paragraph 3(4)(a) is similarly a “quibble”, and there is no material difference between the two provisions in this respect.
- (iii) There are a number of authorities that make it clear that where a power of a public body is subject to a statutory requirement of consent, the requirement of consent limits the vires of the body so far as that power is concerned. For example, in *Crédit Suisse [1997] QB 306*, 317 Neill LJ referred to local authority's power to borrow under [section 172](#) of and [Schedule 13 to the Local Government Act 1972](#) for a purpose or class of purpose approved by the Secretary of State, and noted that “a local authority's power to borrow was effectively constrained by the need to obtain the approval of the Secretary of State”.
- (iv) Further, as Neill LJ noted in *Crédit Suisse*, at pp 317 and 332–333, there is an important policy underpinning the requirement that borrowing is only undertaken with the consent of the Secretary of State, namely, to ensure that central government has control over public borrowing. That control would be undermined if the requirement for the Secretary of State's consent did not limit the capacity of the public authority to borrow.

The Security Argument

174. I was equally unpersuaded by this argument. The claimants' heavy reliance on the word “and” in paragraph 3(4) is misplaced. The provision is more naturally read as referring to the power to do two distinct things: first to borrow money, and

second to grant security in respect of such borrowing, rather than a requirement which only applies power when both things are done together.

175. This analysis is supported by the wording of paragraph 3(3)(a) which plainly treats the borrowing of money and the granting of security in respect of such borrowing as two distinct activities, *both* of which a governing body is distinctly empowered to do. Paragraph 3(4)(a) is naturally to be read as imposing a limit on the entirety of the power referred to in paragraph 3(3)(a), and not simply on those occasions when the power to borrow is exercised on terms whereby security is to be provided. In short, both a decision to borrow, and a decision to provide security for borrowing, require the Secretary of State's written permission.

The Cozens v Brutus Argument

176. As I understood this argument, it was that the word “borrowing” was to be interpreted as an ordinary English word, in accordance with the approach set out in *Cozens v Brutus* [1973] AC 854, it being contended that, as a matter of ordinary English language, the Contract would not be described as a loan. Mr Straker submitted that “no money was taken on loan; equipment was used on payment of a charge just as a ship may be hired for a time charter or a car may be hired on payment of the hire charges. I borrow my friend's car; I hire a car from Avis”.

177. I do not accept Mr Straker's submissions as to the ordinary meaning of the word “borrowing” in paragraph 3(4)(a). Adopting Mr Straker's vehicular analogy, if a person wishes to purchase a car, but is unable to raise the money, and the dealer offers a lease under which the hirer would assume substantially all of the risks and rewards of ownership in return *1965 for periodic payments, with the amount payable being calculated on a basis which reflected the costs of financing being provided to facilitate the transaction, I am satisfied that they would describe this as borrowing.

178. Further, the issue of what constitutes “borrowing” for the purposes of paragraph 3(4)(a) cannot turn on how the transaction is structured or labelled, but must involve consideration of the economic substance of the transaction. Transactions which involve a credit element take a number of different legal forms. For example a common method of commercial borrowing is a repo transaction (repurchase transaction). As Blair J noted in *Första AP-Fonden v Bank of New York Mellon SA/NV* [2013] EWHC 3127 (Comm) at [290]:

“In simple terms, a repo is a transaction in which one party sells an asset (such as fixed-income securities) to another party at one price, and commits to repurchase the asset at a different price in the future. Although a repo is structured legally as a sale and repurchase of the securities, it behaves economically like a secured loan, with the securities acting as collateral.”

179. Unless the issue of what constitutes borrowing is approached as a matter of substance, the control which paragraph 3(4)(a) is intended to impose, and the policy which the requirement for the Secretary of State's consent is intended to serve, would be readily capable of circumvention. The established accounting tests for identifying a finance lease involve an analysis as a matter of substance and not of form. If, as a matter of accounting substance, the Contract is a finance lease, then I am satisfied that it would constitute borrowing so as to engage paragraphs 3(3)(a) and 3(4)(a).

180. By way of further explanation, under IAS 17 (which was the accounting standard used by both Mr Jackson and Mr Smith), a finance lease is a lease which transfers substantially all the risks and rewards incidental to the ownership of an asset to the lessee. The reasons why a finance lease is treated as borrowing as a matter of accounting substance are helpfully explained in notes to the Chartered Institute of Public Finance & Accountancy (CIPFA) Code of Practice on Local Authority Accounting at F67:

“Where a lease is classified as a finance lease, then the substance of the transaction is considered to be the same as if the authority had purchased the asset and financed it through taking out a loan. The authority therefore recognises its interest in the asset together with a liability for the same amount. The lease payments are then treated in a similar way to loan repayments, being split between the repayments of the liability and a finance charge.”

181. I am comforted in my conclusion that entering into a finance lease constitutes borrowing for the purpose of paragraphs 3(3)(a) and 3(4)(a) of Schedule 1 by the fact that this is the received wisdom of those who deal regularly with this issue. The statutory guidance issued by the Department for Education under Schedule 14 to the SSFA expressly identifies a finance lease

as a form of borrowing for [Schedule 1](#) purposes, as does the Council's Scheme. This was also the understanding of Mr Spring, who had considerable experience in asset finance leases and dealings with public bodies, and who said that he was "very well aware that a finance lease is considered to *1966 constitute borrowing". This was also the effect of the legal advice on the basis of which BOSHire and the College proceeded when entering into the Contract. While Mr Straker submitted that the best evidence of the meaning of the word borrowing here was the fact that contemporaneously and for years, "no party described what had occurred as borrowing", this was not because, as a matter of ordinary English, they did not understand that a finance lease constituted borrowing. On the contrary, they had the opposite understanding. It was because they did not understand the Contract to be a finance lease.

The Such Sum Argument

182. This argument proceeded on the basis that the power in paragraph 3(3)(a) to "borrow such sums as the Governing Body think fit", and the restriction on that power in paragraph 3(4)(a), only apply where it was possible to identify a specific sum which the College had decided to borrow, which it was not possible to do in this case. Once again I am unable to accept this submission. The words "such sums as the Governing Body think fit" were not intended to create a limitation on the operation of paragraph 3(4)(a), but to give the Governing Body a discretion as to the amount it borrowed provided the Secretary of State's permission was obtained, making it clear it was for the Governing Body in the first instance to decide how much it wanted to borrow.

183. Where, as in this case, the College chose to enter into a structured transaction which economically incorporates borrowing, but did not choose to disaggregate the amounts it had agreed to pay into their constituent elements, that does not have the effect that that the College has not, after all, purported to exercise its power to borrow. It has purported to exercise its power to borrow that element of the total amount being paid which reflects the credit element of the transaction. The argument that the College was freed from the limitation created by paragraph 3(4)(a) because, in Mr Straker's words, "the Governing Body does not appear to have done any sums" is a wholly unattractive one, which would have the result that deficiencies in due diligence and financial analysis would enlarge the contracting capacity of a public body. The argument has nothing to commend it.

Was the Contract a finance lease or an operating lease?

IAS 17

184. As I have noted above, the parties' accounting experts proceeded for the purpose of their evidence on the basis that the accounting standard which falls to be applied in determining whether the Contract is a finance or operating lease is IAS 17 (which applies to the Council in accordance with the CIPFA Code of Practice on Local Authority Accounting).

185. The key question under IAS 17 for the purposes of identifying an operating lease is whether the lease transfers substantially all the risks and rewards incidental to ownership to the lessee. In order to answer that question IAS 17 provides as follows:

"10. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are: (a) the *1967 lease transfers ownership of the asset to the lessee by the end of the lease term; (b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised; (c) the lease term is for the major part of the economic life of the asset even if title is not transferred; (d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and (e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

"11. Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are: (a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee; (b) gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and (c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

"12. The examples and indicators in paras 10 and 11 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset transfers at the end of the lease for a variable payment

equal to its then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all such risks and rewards.”

The proper approach to lease classification

186. There was much common ground between Mr Jackson and Mr Smith on the proper approach to classification of a lease pursuant to this standard. They agreed that: (i) lease classification involves the exercise of judgment by an accountant; (ii) this is a qualitative exercise which is informed by certain quantitative assessments; (iii) in order to classify a lease it is necessary for an accountant to consider all the relevant circumstances before forming a view; and (iv) IAS 17 is split into primary indicators (the first five indicators in para 10) and other indicators (those in para 11) and a practitioner would place more weight on the five primary indicators rather than the three other indicators.

187. There was a difference between the claimants and defendants as to the proper approach to the primary indicators. The defendants contended that the statement that those five situations “*individually* or in combination would normally lead to the classification of a finance lease” (emphasis added) meant that if it was shown that just one of those factors was present, that would be sufficient to make the lease a finance lease. In contrast, the claimants emphasised the point of agreement between the experts that lease classification requires consideration of all the circumstances before reaching a conclusion. The claimants also relied on the statement in the first sentence of para 12 of IAS 17 that the indicators are not always conclusive.

188. It was Mr Smith's evidence that, generally, if any one of the primary indicators is present then the lease will be classified as a finance lease. In cross-examination, *1968 Mr Jackson disagreed with this view. However, it is clear from the words “individually or in combination” in IAS 17 that one indicator *can* be sufficient to cause a lease to be classified as a finance lease, and the guidance issued by KPMG suggests that this will generally be the case. No doubt there will be cases where it will not be appropriate to draw that conclusion on the basis of a single factor.

189. The claimants argued that there was no distinction between primary and secondary indicators because the expressions “primary” and “secondary” do not appear in IAS 17. However, this dual-classification was supported by both accounting experts in their joint memorandum, which records that “the experts are agreed that IAS 17 is split into primary indicators and other indicators” and that “an accounting practitioner would place more weighting in practice to the five primary indicators”. The distinction was also reflected in guidance material produced by Deloitte, KPMG and CIPFA. I am satisfied that the terminology fairly reflects the relative importance of the matters identified in paras 10 and 11 of IAS 17.

Who decides if a lease is a finance or operating lease and when?

190. The issue of whether the Contract constituted borrowing is, in the final analysis, a question for the court on the evidence before it, the status of the lease to be determined at the time it is concluded, rather than at the date of the hearing. That offers the unattractive possibility of two different but equally reasonable judgments as to the status of the Contract being reached at different points in time, something which would be wholly incompatible with commercial certainty and leave the parties’ dealings in a permanently unsettled state. The practical, rather than analytical, answer to that conundrum is that if the lease is classified as a finance lease at the time, applying the correct principles and using inputs which fall within the range of reasonable values, a court is likely be reluctant to disturb that classification at a subsequent hearing merely because the choice of other values from the range of reasonable options would have led to a different conclusion.

191. In this case, however, there is no evidence of the College performing any IAS 17 calculation at the time. I accept Mr Stiltz's submission for the Council that the College “simply took on trust BOS Hire's repeated assertions that the ... Contract was an operating lease”. Nor did the claimants seek to adduce evidence of expert consideration which was given to the issue before the Contract was signed, nor to establish and verify the inputs to whatever contemporaneous calculations they may have performed. Rather than putting forward and seeking to defend a contemporaneous assessment, the claimants have relied upon a retrospective calculation performed by their experts for the purposes of the trial.

192. IAS 17 distinguishes “between the inception of the lease (when leases are classified) and the commencement of the lease term (when recognition takes place)”. The inception of the lease is the earlier of the date of the lease, or the date of commitment by the parties to its principal provisions (para 13). In circumstances in which BOS Hire kept its options open until signing the

lease on 30 April 2013, while it worked out if it could finance the transaction, I am satisfied that the date of 30 April 2013 is the relevant inception date for IAS 17 purposes. The lease term commenced in September 2013.

193. The directions given by Knowles J for the trial on 30 April 2019 provided for the expert accountancy and valuation reports to be served **1969* sequentially, with the claimants going first. The expert report prepared by Mr Jackson for the claimants performed one of the calculations referred to in IAS 17—the so-called PVMLP calculation which I address further below—using inputs for the value of the Building derived from the claimants’ valuation expert, Mr Dodson. Mr Dodson was instructed to value the Building “at the date of practical completion, being 5 September 2013”, and Mr Jackson used that input in his calculations. In his responsive valuation report, unsurprisingly, Mr Manley for the defendants was also instructed to and did value the Building as at 5 September 2013. Again, unsurprisingly the defendants’ accounting expert Mr Smith used the two competing 5 September 2013 valuations as inputs in his report. The accountancy experts’ joint meeting used the valuations which the valuation experts had provided, agreeing that “if Mr Manley’s valuation is preferred, then the PVMLP test would be met for finance leasing classification”, and that “if Mr Dodson’s valuation evidence is preferred, then the PVMLP test may or may not be met for finance lease classification”. The experts’ consideration of the specialised use issue (another IAS 17 test which I address below) also expressed differing conclusions dependent on whether “Mr Manley’s valuation evidence is preferred” or “Mr Dodson’s valuation is preferred”. There were a number of other references to the same effect. In short, the expert evidence proceeded at all times on the basis that the value of the Building to be used in the present value of the minimum lease payments (“PVMLP”) calculations was the value as at September 2013.

194. However, in his cross-examination of Mr Smith, Mr Straker suggested that the correct date for classifying the lease was either February 2013 (when the College signed the Contract) or April 2013 (when BOS Hire signed the Contract). Mr Straker then submitted in closing that the relevant inception date was in April 2013 and that there was no evidence of the proper classification or value of the lease at that date. Until Mr Straker’s cross-examination, there was no hint from the claimants that they might seek to challenge 5 September 2013 as the appropriate classification date, or to suggest that the valuation evidence had been prepared at the wrong date with the result that there was an evidential gap on the borrowing issue. As a result, the defendants were unable to explore this issue with Mr Jackson in the course of his cross-examination, or to adduce evidence of the value of the Building as at 30 April 2013.

195. In circumstances in which it was the claimants themselves who selected September 2013 as the valuation date, to which the defendants’ expert then responded, and in which the defendants were unable to adduce expert evidence-in-chief from Mr Smith on this issue, nor to explore the issue with Mr Jackson in cross-examination, it was in my view too late for the claimants to seek to take the point that the valuation evidence had been prepared at the wrong date.

196. Further, para 13 of IAS 17 provides that where the parties agree to change the provisions of the lease in a manner that would have resulted in a different classification of the lease, the revised agreement is to be regarded as a new agreement over its term. If the Contract was already a finance lease as at 30 April 2013, then para 13 would not matter. But if one were to assume in the claimants’ favour that the Contract would not have been a finance lease as at April 2013, then the effect of the variations in the rent amount as at July and September 2013 would have to be considered, with any classification **1970* of the lease as a finance lease as at September 2013 leading to the Contract being defined as a finance lease throughout its term. While this aspect of IAS 17 was confirmed by Mr Smith in re-examination, this issue was not considered in the experts’ reports, and there were no submissions as to how any reclassification of the Contract under para 13 of IAS 17 would impact on the operation of [paragraph 3\(4\)\(a\) of Schedule 1](#). The fact that the defendants were deprived of a proper opportunity to explore the effect of para 13 of IAS 17 in this respect because of the late stage at which the claimants sought to take this point is a further reason why I have concluded that the point is not open to them.

197. Finally, there was no evidence before me to suggest that there is likely to be any significant difference in the value of the Building at April and September 2013. In circumstances, in which the defendants could not be criticised for preparing their valuation evidence at this date, and doing the best I can on the evidence which I do have, I am not persuaded that there is any difference in the value of the Building, whether determined as at April 2013 or September 2013, and certainly none sufficient to affect the classification of the Contract for IAS 17 purposes.

Primary indicators (a) and (b): transfer of ownership and option to purchase

198. I should record that it was common ground that two of the primary indicators of a finance lease—whether ownership of the asset passed to the lessee at the end of the lease term, and whether the lessee had an option to purchase the asset at a price that made it reasonably certain at inception that the option would be exercised—were not present in this case. The fact that

the College wished to purchase the Building, and that BOS Hire had stated—without committing itself—that it was likely to respond favourably to such a request does not change the position.

199. The defendants' case focused on primary indicators (c), (d) and (e).

Primary indicator (d): Present value of minimum lease payments

200. As I have stated, primary indicator (d) is “whether at the inception of the lease the present value of the minimum lease payments [‘PVMLP’] amounts to at least substantially all of the fair value of the leased asset”. Mr Jackson described this factor as the “key indicator” of lease classification.

“Substantially all”

201. The first issue is what counts as “substantially all”. There is no express threshold percentage ratio stated in IAS 17.

202. Mr Jackson's evidence was that this is generally taken to be a minimum of 90% although practitioners can apply different percentages. Mr Smith's evidence was that some accountants use a 90% figure, but that since neither IAS 17 nor the guidance on IAS 17 given by KPMG and Deloitte refer to the 90% figure, it should be approached with caution. In his view, there is no single bright numerical line, rather an accountant must exercise his judgment by applying the test of “substantially all” according to the ordinary meaning of those words. **1971*

203. The Council's own accounting policy states:

“One of the key tests for classification of finance leases is that lease payments are substantially all of the fair value of the asset. The council has defined substantial as being where minimum lease payments are at least 70% of the fair value of the leased asset. All other leases are classified as operating leases.”

204. Mr Jackson resisted the suggestion that the Council's policy involved classifying leases in which the minimum payments were in excess of 70% of fair value as finance leases. However, it is clear that the Council were treating the primary indicator of whether the PVMLP amounted to substantially all of the fair value of the leased asset as a “key test”, and one which would be satisfied if the PVMLP exceeded 70% of fair value.

205. In closing, the College and the Council submitted this 70% threshold should be applied for the purpose of classifying the Contract because it was open to bodies to define “substantially all” in their accounting policies, the Council had done so at 70% and, if the College had formed an assessment of finance lease classification, it should have done so using the Council's policies. This argument gives rise to a number of potential issues:

(i) First, it would involve the application of paragraph 3(4)(a) varying depending on the accounting policies adopted in a particular case rather than the court determining the issue by applying the “substantially all” test. That could produce what might be thought to be the unattractive position that two identical transactions would fall to be treated differently depending on the accounting policy adopted by the lessee.

(ii) Second, both the lessor and lessee can define their own accounting policies, raising the prospect that the transaction might constitute borrowing from the perspective of the lessee but not from the perspective of the lessor.

(iii) Finally, the legal basis on which it was said that the Council's accounting policy should determine the status of the Contract for the College, in circumstances in which I have found that the College was not acting as the agent of the Council, was not the subject of any detailed submissions at the trial.

206. In circumstances in which the issue of whether the 70% test applies does not affect my determination of the classification of the Contract, I have decided to proceed on the basis of Mr Smith's evidence that “substantially all” is not defined by a single numerical bright line, but falls to be applied in the light of other circumstances. As it happens, I have concluded that the Contract constitutes a finance lease even using the 90% PVLMP test for which the claimants contends. However, this should not be regarded as an endorsement of the 90% test for all purposes. There are a wide variety of assets which may be the subject of asset leases, and in which the classification of the lease as an operating or finance lease is of critical importance to the commercial viability of the transaction. Some of these are assets which are essentially fungible, eminently transportable and generally subject

to lease terms of at most a few years (for example IT equipment or office furniture). By contrast, this case involves a modular building, installed on site after substantial preparatory and groundwork, designed to meet the lessee's specialised requirements, subject to a 15-year lease term and which it would involve a significant financial and logistical effort to relocate. These are characteristics which might be thought to test the outer limits of the concept *1972 of an operating lease, and to make the use of a lower PVMLP threshold more prudent.

The PVMLP ratio under the Contract

207. The PVMLP ratio is a function of: (i) the fair value of the leased asset at inception; (ii) the interest rate implicit in the lease (which in turn depends inter alia on the unguaranteed residual value of the asset); and (iii) the minimum lease payments. While (iii) is set by the Contract, both (i) and (ii) are matters of assessment.

208. In simple terms, the lower (i) and (ii) (as well as the unguaranteed residual value of the asset) were relative to (iii), the more likely it was that the PVMLP amounted to substantially all of the value of the Building at inception.

209. Mr Jackson and Mr Smith's analysis of the PVMLP under the Contract was therefore dependent on the expert evidence of Mr Dodson and Mr Manley as to the value of the Building (i) at inception (which for the reasons set out above I have concluded is to be taken as their valuations as at 5 September 2013) and (ii) the unguaranteed residual value of the asset at the end of the lease. In this regard, it is important to note that Mr Jackson and Mr Smith were agreed that if Mr Manley's expert valuation evidence was to be preferred, even just on (i), then the Contract was a finance lease.

210. A major tension in the valuation evidence arises from the fact that the value of the Building is different in situ and ex situ. An in situ valuation contemplates that the Building is fixed and so can cover works which would be non-recoverable were the asset relocated such as preliminary works and groundworks. Conversely, an ex situ valuation conceives of the Building as a chattel which is relocatable so that those non-recoverable works cannot form part of the valuation (because their value cannot be realised ex situ, and indeed similar works would be required by any subsequent lessee of the Building).

211. In the following sections, I review the evidence on each of the three inputs before explaining my overall conclusion on the PVMLP.

(i) Fair value

212. Mr Dodson adopted as his valuation in situ the cost of completion certified by the Bailey Partnership, namely £7,147,039. This equated to around £2,400 per square metre. Importantly, this value included substantial sums for preliminaries and groundworks.

213. In contrast, Mr Manley valued the Building in situ on four different valuation approaches using guidance from the Royal Institute of Chartered Surveyors ("RICS"). Applying a weighted analysis of the outputs of those four approaches, he valued the Building at £4,540,000. This equated to £1,519 per square metre.

214. I am satisfied that the valuation put forward by Mr Dodson is too high: (i) Mr Dodson cited a number of comparator relocatable buildings used by other schools in his reports. Mr Manley calculated that the cost of build per square metre for these comparables amounted to £1,543, around £800 less than the £2,400 per square metre figure which Mr Dodson used. I agree with the defendants that Mr Dodson's own comparables suggest that his in situ valuation is significantly too high. (ii) Mr Dodson's valuation on this basis is very substantially in excess of the quotation for a modular building which the College obtained from McAvoy of under £4m plus VAT in *1973 March 2011, even allowing for the time interval between the two quotations. (iii) Mr Dodson's approach assumes that the value of the Building was represented by the amount paid to BOS for the construction of the Building. However, I do not believe that this is an appropriate assumption, particularly in circumstances (as I explain below) in which the College made no real attempt to negotiate the hire figures down and in which BOS and BOS Hire were not dealing at arm's length.

215. Mr Dodson's response to the suggestion that his valuation was out of line with his own comparables was to suggest that this was not the case once non-recoverable costs such as preliminaries and groundworks were removed from the Bailey Partnership figure. If just preliminaries and groundworks were deducted, then on Mr Dodson's approach the fair value at inception would be £5,722,143. If all non-recoverable costs were deducted, that value would be £5.33m.

216. I do not accept that this explains the discrepancy. Mr Dodson accepted that he did not know whether his comparables included groundworks and preliminaries (he accepted that “we don’t know what is included in these costs”). In any event, Mr Dodson's response reveals a further difficulty with the claimants’ analysis, namely that it involved assessing fair value on an in situ basis (i.e. the Building as completed on site at the College), in circumstances in which the claimants’ residual value calculation necessarily had to be done on an ex situ basis (its value as an asset capable of being disposed of to someone other than the lessee at the end of the lease). This is the case because, for IAS 17 purposes, it was necessary for the claimants to establish that at the end of the lease, the Building had a residual value on a third party disposal. In so far as the claimants sought to rely on an ex situ valuation of the Building, such a valuation cannot include work the value of which is not capable of being enjoyed at another location and which would therefore have no value to a subsequent lessee. In circumstances in which the claimants’ PVMLP case was heavily dependent on the Building being relocatable, such that it could be said to have a further significant economic life at the end of the lease to the College, it was not appropriate for the claimants to conduct the PVMLP calculation on a basis which included the value of non-transferrable work within the calculation of the fair value of the Building at inception.

217. In addition to using Mr Dodson's valuation, Mr Jackson also used the insurance value of the Building, as stated in the Contract of £6,953,000 which he uplifted by reference both to the cost of the variation works done between April and September 2013 (which came to £487,000) and interest costs. This produced a figure of £7,634,189. Mr Jackson then took the midpoint between Mr Dodson's valuation and his own calculation as his fair value.

218. I am unable to place reliance on this assessment of the Building's value:

- (i) To the extent it depends on Mr Dodson's valuation, it suffers from the weaknesses I have identified above.
- (ii) I do not regard the value for which the claimants required the Building to be insured at the College's expense as a particularly satisfactory method of valuing the Building. It is certainly much less reliable than Mr Manley's weighted valuation approach. *1974
- (iii) The groundworks represented 30% of the insurance value defined in the Contract and used by Mr Jackson, raising the same issue as that which arises on Mr Dodson's valuation using the Bailey Partnership figure. When those costs are excluded, as the Council did when calculating the insurance value of the Building, the value was £4.9m.
- (iv) Further, it is not appropriate to uplift the insurance value by £487,000 for additional work, in circumstances in which the additional works did not lead to any increase in the required insurance value.

219. In conclusion:

- (i) Valued on an in situ basis, I am satisfied that the value of the Building was substantially less than the figures of in excess of £7m used by both Mr Dodson and Mr Jackson. I have found the methodology by which Mr Manley's valuation of £4,540,000 to be more reliable, but I accept that this might understate the value of the Building. However, I am satisfied on the evidence before me that the in situ value of the Building did not on any view exceed £6m.
- (ii) On an ex situ basis, on the claimants’ own figures, the value of the Building cannot have exceeded £5.35m (the Bailey Partnership figure less non-recoverable costs). For reasons I explain below, I am satisfied that the ex situ value of the Building as at September 2013 is very substantially less than that.

(ii) Residual Value

220. It was common ground that at the end of the Contract, there were in principle four options for the future use of the Building: either in situ sale or re-lease to the College; or ex situ sale or re-lease to a third party. Importantly, it was common ground that, if an ex situ sale or re-lease were not economically viable, this would suggest that the Contract was a finance lease (because, on an in situ basis, any money received in respect of residual value would have to be paid by the College).

221. The claimants did not tender any expert valuation evidence as to the residual value at lease expiry (in 2028). This was despite Mr Jackson explaining in his written evidence that assessing the residual value is the most judgmental part of the PVMLP calculation. Mr Dodson stated that he had not been instructed to provide such a valuation. As there was no proper consideration of this issue in Mr Dodson's report (to which Mr Manley would have had an opportunity to reply), I do not feel able to rely on Mr Dodson's suggestion made for the first time in cross-examination (which I did not find it particularly easy to follow) that the residual value of the Building was unlikely to change between 2019 and 2028, save to say that my initial reaction is that this is implausible.

222. The claimants' failure to proffer expert evidence on this issue meant that their case on residual value was entirely premised on a set of assumptions adopted by Mr Jackson, whose expertise did not extend to the valuation of the Building. Mr Jackson calculated residual value in two ways. First, on a "lessor return" model, he calculated an estimate of initial residual value of £1,461,440. This represented the total cost of the Building (£7,580,730) less the initial payment under the Contract (£1,001,762) and the sale of rights to SFM and subsequently GCP. He then uplifted that initial residual value by RPI (for which he used a figure of 5·6%) on the assumption that an investor would hope to make a return on their investment at least equal to inflation. *1975 Second, on a "building cost inflation" approach, he took the value of the building in 2013 and uplifted it to reflect inflation by RPI (once again using a 5·6% figure). He then applied a 70% reduction to that figure, on the basis of a statement in Mr Dodson's report that the ex situ value attributed to a modular building is 30% of the cost of a similar new building.

223. Mr Jackson's calculations both used an RPI figure of 5·6%. Mr Smith's evidence was that this figure was inappropriate. In Mr Smith's opinion, an appropriate RPI rate was around 3%, because the rate in 2013 was 3% and the five-year rate to 2013 was 3%. I have concluded that Mr Smith's criticisms of the RPI rate used by Mr Jackson are justified:

- (i) Mr Jackson's 5·6% figure was arrived at by taking an average RPI for the period from 1949 to 2013. That included the unusually high inflation of the 1970s and 1980s which had the effect of increasing the average RPI. It is for this reason that the RPI figure used by Mr Jackson is considerably higher than the other RPI rates canvassed and above the average rate from the early 1990s to 2013 which Mr Jackson explained in cross-examination, he had calculated to be 3·6%.
- (ii) In justifying his approach, Mr Jackson relied on the "uncertain economic times" caused by Brexit. However, when giving his oral evidence, it transpired that he had never previously calculated RPI in this manner and he said that it was "the upper limit of what could be acceptable for an accountant".
- (iii) I am in no doubt that the RPI figure used in Mr Jackson's report was not one which it was appropriate to use. I have concluded an RPI of 3% is appropriate, for the reasons which Mr Smith gave.

224. In addition to the RPI issue, there are other obvious difficulties with Mr Jackson's "lessor return" model (ie assuming that an investor would expect to make a return on their investment which was at least equal to inflation). Mr Jackson's assumes that the transaction was undertaken with a view to a particular level of profit, rather than as a "reference project" to promote future transactions. The assumption also fails to address the fact that the level of return the lessor hoped to achieve might depend on achieving a sale or re-lease to the College, rather than a third party, at the end of the minimum lease period. Mr Spring gave the following revealing evidence on this issue:

"We were taking a real risk on the future value and there was a lot of uncertainty with the lessor about whether it would ultimately be barely profitable, or perhaps even a small loss or break-even, or whether it would actually be a lot more profitable if you could actually achieve an in situ disposal which is always—the ambition of any operating lessor is to make an in situ disposal because that's the way you actually make your return ." (Emphasis added.)

225. Further, Mr Jackson's "lessor return" approach did not appear to have factored in the costs which would be incurred by the College and SFM, in the event of an ex situ re-lease or resale, in refurbishing, reconfiguring and transporting the Building. These were estimated by Mr Dodson at £1·2m. Mr Jackson confirmed that it would be appropriate to consider residual values net of "selling costs". That logic would dictate that the residual value in an ex situ scenario should be considered net of refurbishment, reconfiguration and transport costs too. In cross-examination, Mr Jackson *1976 appeared to accept that residual value should be considered net of these costs but suggested that he had done so by applying the 70% reduction referred to above. However, the reduction appears to have been performed only on Mr Jackson's "building costs inflation" approach and not his "lessor return" approach. There is nothing in Mr Jackson's report to show any part of the £1·2m figure was reflected in Mr Jackson's lessor return calculation, and I am not persuaded that it was.

226. So far as the Building cost calculation is concerned:

- (i) The use of RPI of 5·6% per year is inappropriate for the reasons I have set out above.
- (ii) The residual value was calculated by taking 30% of the initial residual value uplifted for inflation. However the 30% figure which Mr Jackson relied upon was not put forward by Mr Dodson as an independent means of establishing the proportion of ex situ value which survived at the end of the lease. Mr Dodson appears to have used the 70% figure as a rough and ready way of testing his conclusions rather than a means of arriving at a reliable calculation of residual value in its own right.
- (iii) In short, this is an assessment of value entirely dependent on the use of assumptions, which I have held to be unreliable.

227. Mr Manley's assessment of the residual value in 2028 was that ex situ, the Building would be worthless. In situ, he valued it at £1.54m. This was arrived at using the same valuation methodologies he had used when arriving at his valuation as at November 2019, using what he referred to as an accepted convention to "take the current market circumstances and assume that the building is pro-rata at that number of years older", but with an appropriate reduction to reflect the current state of the building and the cost of bringing it up to market standard. I accept the evidence of Mr Manley and Mr Pincott, who inspected the Building and produced a detailed documentary and photographic record of that inspection, that some adjustment for the state of the Building is required.

228. As the only end-of-lease valuation I have, and given Mr Manley's clear expertise as a valuer, I accept Mr Manley's £1.54m in situ valuation at the end of the lease. The question of residual value was necessarily a matter for valuation experts rather than for accounting experts and Mr Jackson's assumption-based approach cannot fill the evidential lacuna resulting from the lack of valuation evidence on this topic from Mr Dodson.

229. I also accept Mr Manley's evidence that the ex situ valuation of the Building at the end of the lease is likely to have been insignificant once the costs of dislocation, transport, reconditioning, marketing, reconfiguration to a new user's requirements, and reinstallation are taken into account. There are a number of "sense checks" which tell strongly against any suggestion that the Building had a significant ex situ value post-installation (and certainly by 2019):

(i) It was the evidence of Mr Pierce that BOS, and the modular building industry in general, wrote off any residual value in leased modular buildings after five years.

(ii) In explaining why no credit was given in the calculation to be performed under the Contract for the residual value of the Building following a repudiation of the Contract, Mr Spring explained: **1977*

"It is highly uncertain whether the building could be sold or re-let on terms that would represent a value equivalent to the lost income stream and, in any event, the lead time required to identify a subsequent user of modular buildings to a compatible design, which would allow the building to be reutilised without major refurbishment, would be very substantial, *if it could be achieved at all.*" (Emphasis added.)

(iii) Finally, it is striking that while the claimants wrote terminating the College's right to use the Building in April 2018, at a much earlier point in the life of the Building than if the full 15-year term had run, they have made no effort to repossess it. That inertia is consistent with the ex situ value of the Building already being insignificant, and it would only have reduced after a further ten years.

(iii) Minimum lease payments under the Contract

230. All parties and their experts assumed that the minimum lease payments remained constant, being the payments specified under the Contract. However, the Contract required the College to pay a substantial additional sum at the termination of the Contract because the College was responsible for returning the Building to BOSHire in good and reasonable clean condition, with the College liable for all costs of inspection, loading, unloading and transportation.

231. In his report, Mr Jackson stated:

"If [the College] was to bear the costs of dismantling then this would be expected to reduce risk from SFM's perspective, and so increase the likelihood of it being a finance lease. If [the College] was to, say, bear £400,000 of the relocation costs and this was considered to represent a minimum lease payment under the Hire Contract then this would increase the PVMPLS ratio by approximately 0.6%."

232. Under IAS 17 minimum lease payments are "payments over the lease term that the lessee is or can be required to make". There was no discussion before me of whether payments the lessee could be required to make to third parties for dismantling, transportation etc fell within this definition, and accordingly I have ignored any uplift in the minimum lease payments which might result from including these costs. This may involve an element of conservativeness in the calculation, in the claimants' favour.

Conclusion on the PVMLP ratio of the Contract

233. On the basis of these conclusions, I am satisfied at the inception of the lease the PVMLP amounted to “substantially all of the fair value of the leased asset”:

- (i) Even assuming in the claimants’ favour that the relevant threshold for “substantially all” is 90%, if even one of Mr Jackson’s inputs is adjusted in a manner adverse to the claimants, the 90% threshold is exceeded.
- (ii) I have concluded that a number of adjustments to those inputs are required, each of which would increase the PVMLP percentage above the 90% threshold.
- (iii) First, the RPI used should be corrected from 5·6% to 3%. Even if Mr Jackson’s alternative RPI figure of 4·5% was used, then PVMLP would still be above 90%. *1978
- (iv) Second I have accepted Mr Manley’s evidence that the Building had a residual value in situ of £1,540,000 and concluded that its ex situ residual value was insignificant.
- (v) Third, I have concluded that the fair value in situ cannot have exceeded £6m, and that the fair value ex situ (which the logic of the claimants’ position requires them to use) should not include the preliminaries and groundworks, on which basis it cannot exceed £5·35m even on the claimants’ own figures.

234. It is worth noting that, on Mr Jackson’s analysis and using his RPI rate of 5·6%, the PVMLP ratio is 88%. Only on the further assumption suggested by Mr Jackson—that SFM would expect to make a return of 8%—did Mr Jackson’s calculation of the PVMLP ratio fall to 84·6%. However, Mr Jackson accepted that the calculation of residual value premised on an ex situ sale or re-lease could not (sensibly) be calculated using this assumption. Putting that assumption aside, even if all of Mr Jackson’s inputs were accepted, the PVMLP ratio does not fall below 88%. On the basis of Mr Smith’s expert evidence, which I have accepted, that there is no “bright line” test of 90% under IAS 17, that would in my view amount to “substantially all” of the fair value of the Building.

Primary indicators (c) and (e): Specialised asset and economic life

235. Primary indicator (c) provides: “the lease term is for the major part of the economic life of the asset even if title is not transferred”. Primary indicator (e) provides: “the leased assets are of such a specialised nature that only the lessee can use them without major modifications”.

What is “the asset”?

236. A preliminary question arises as to the identification of the asset or assets to which these tests should be applied. It appeared to be the claimants’ case that the relevant assets were the 81 relocatable units of which the Building was constructed, rather than the Building per se. This classification was intended to facilitate the argument that reuse of “the asset” was possible without major modifications. While the 81 relocatable units were of varying lengths and widths, at their most basic level they were simply 81 homogeneous steel frames.

237. In response, the defendants pointed to the Contract definition (which the claimants tended to quote only in part rather than in full). The “Equipment Description” provided:

“Double storey sixth form teaching accommodation block constructed from 81 no relocatable units all in accordance with Supplier’s drawings re AQ194–06–2000=F and AQ194–06–2100-D and technical specification ref AO194–06–9000-F.”

238. Those drawings make it clear that the Building comprised, inter alia, an assembly hall, classrooms, workshops, laboratories, studios and a café, and was to be built, configured and finished, both internally and externally, according to a detailed and bespoke plan.

239. I have concluded that the defendants’ submissions are to be preferred and that the asset for the purposes of primary indicators (e) and (c) is *1979 the Building as described in the full contract description. It is the cost of providing that Building finished in accordance with the specification in the Contract, rather than the cost of 81 steel frames, which the fair value of the Building represents, and which drove the size of the lease payments.

Primary indicator (e)

240. It was common ground between the parties that this was primarily a question for the valuation experts. It was agreed that sale or re-lease of the Building to a third party would involve three steps: (i) dismantling the Building into units; (ii) refurbishing and reconfiguring those units to a new design; (iii) installing those units on another location.

241. Mr Manley's evidence, which Mr Dodson agreed with, was that disassembly would require, inter alia, cutting through the existing bolts, and separating the slices and external cladding which currently connects the units in the Building. A 100 tonne crane or equivalent (on Mr Pierce's evidence a number of smaller cranes were used to install the Building) would be needed to move the units, and 81 separate lorry loads would be needed to transport the units to their new destination. If this location was not on the Isle of Wight, a ferry crossing would be required.

242. On Mr Dodson's evidence, the cost of refurbishment and reconfiguration would be £1.2m and the cost of installation would be £2.55m. Mr Manley suggested that the figures would be substantially higher.

243. On Mr Dodson's evidence alone, it is clear that the Building was of such a specialised nature that only the lessee could use it without major modifications. In any event, I am not persuaded by Mr Dodson's evidence that there would have been any demand for the restored and reconfigured Building at the end of the lease so as to make removal, restoration, reconfiguration and reinstallation an economically viable proposition.

244. I accept that there is a market for reused modular buildings. Mr Manley drew a distinction in this connection between permanent modular buildings and temporary modular buildings, suggesting that while the latter have a generic character and are frequently reused, the former are not. Mr Manley's evidence was that some modular buildings are intended to be permanent and are built as such. Their design is generally more complex and not conducive to relocation. In contrast, temporary modular buildings are designed with relocation in mind. The most familiar example of these are portacabins. Given these differences in design, it was Mr Manley's opinion that the relocation of permanent modular buildings is more expensive and complex than the relocation of temporary modular buildings. Mr Manley's evidence was that the Building was a permanent modular building whose relocation, while technically feasible, was not economically viable.

245. The claimants disputed the existence of a distinction between temporary and permanent modular buildings, contending that it was both technically and economically feasible to relocate the Building and buildings like it. This issue was the subject of evidence from Mr Pierce, and also Mr Dodson. To support his evidence that it was economically feasible to relocate the Building at the end of the lease, Mr Dodson attached extracts from webpages or trade publications featuring a number of school buildings built using modular construction. It was the claimants' case, largely pursued through the cross-examination of Mr Manley, that these buildings were comparable to the Building and that they were all relocatable. **1980*

246. There were two difficulties with this approach. First, the documents which Mr Dodson had exhibited, and on which the cross-examination was based, contained relatively limited detail, often giving no information about the materials used, the internal finish of the buildings and the wider context in which they had been built, other than that which could be discerned from the photographs. Second, it was Mr Manley's evidence, which I accept, that these communications, as sales publications with potential customers as their intended audience, were likely to emphasise the potential for relocation of modular buildings without explaining that, depending on the design of such buildings, such relocation might be complex and expensive, to the point of being uneconomic.

247. I found a specific focus on the characteristics of the Building, rather than alleged comparisons with other buildings, the most reliable means of determining whether the Building was relocatable and re-leasable once installed in situ. In cross-examination, Mr Dodson confirmed that the 81 units, once configured to form the Building, were put to heterogeneous uses, with varied internal finishes. The electrical wiring, the plumbing and the partition walls were different in almost every unit. Mr Dodson accepted that the Building was intended for permanent use and that the College expected to occupy the building for its "natural life". In my view, that reflects the reality of the situation. The Building was intended for permanent use on its original site and was designed in accordance with that intention. The claimants themselves, in submissions filed on 1 April 2020, described the Building as having been "compiled to the specific and exact specifications of the College". The dismantling, refurbishment, reconfiguration and reinstallation, which Mr Dodson accepted would be necessary before the Building could be used by a third party, not only amounted to "major modifications", within any ordinary understanding of that term, but also made any profitable third party disposal of the Building at the end of the 15-year term unlikely.

Primary indicator (c)

248. Mr Jackson and Mr Smith agreed that if Mr Manley's evidence is preferred, such that the primary indicator (e) specialised asset test is met, then the Building will also meet the primary indicator (c) economic life test for finance lease classification, as the economic life of the asset would be consumed by the College. As I have concluded that the specialised asset test is met, it follows that primary indicator (c) is also satisfied.

Conclusion

249. All of primary indicators (c), (d) and (e) point to the classification of the Contract as a finance lease. As explained above, the proper approach to IAS 17 is that, if any of the primary indicators is present, a lease will generally be classified as a finance lease. In this case, three of the primary indicators are satisfied. Whether one employs the qualitative approach emphatically advocated by the claimants, or considers the weight to be accorded to each of these factors, the answer is clear: the Contract was a finance lease.

250. As the Contract is properly classified as a finance lease, it follows that the Contract involved borrowing. It is common ground that the Contract was entered into without the permission of the Secretary of State, which I have **1981* found constituted a limitation on the College's power to borrow. It therefore follows that the Contract was ultra vires the College and was void.

251. Before leaving this issue, I should refer to a matter much pressed by the claimants in argument: that BOS Hire, the College and the others routinely referred to the Contract as an operating lease, the Contract so described itself, and that no one disagreed with that classification until April 2018.

252. The parties' own descriptions cannot be decisive of an issue which turns on the economic substance of the transaction. Lord Templeman's observations in *Street v Mountford [1985] AC 809*, 819 are very much on point:

“In the present case, the agreement dated 7 March 1983 professed an intention by both parties to create a licence and their belief that they had in fact created a licence. It was submitted on behalf of Mr Street that the court cannot in these circumstances decide that the agreement created a tenancy without interfering with the freedom of contract enjoyed by both parties. My Lords, Mr Street enjoyed freedom to offer Mrs Mountford the right to occupy the rooms comprised in the agreement on such lawful terms as Mr Street pleased. Mrs Mountford enjoyed freedom to negotiate with Mr Street to obtain different terms. Both parties enjoyed freedom to contract or not to contract and both parties exercised that freedom by contracting on the terms set forth in the written agreement and on no other terms. But the consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence. The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.”

253. The question of what constitutes borrowing under [paragraph 3\(4\)\(a\) of Schedule 1](#) is not a self-certification scheme, but a matter to be determined on the objective facts. There is no evidence of anyone on the College or Council's side ever having performed the in-depth analysis necessary to arrive at an informed application of IAS 17, and in the absence of such analysis, the fact that individuals or entities were willing to treat the Contract as what it professed on its face to be is neither here nor there. This also answers Mr Straker's points that none of the extensive powers capable of being invoked against the College in the event of financial mismanagement were ever exercised. Unless and until the detailed analysis had been performed to allow a meaningful conclusion on the question of the Contract's classification, there was simply no basis for any such powers to be invoked, even assuming the political will had existed to do so. Now that that analysis has been performed, the proper classification of the Contract admits of no real doubt.

254. For the same reason, the claimants' invocation of the presumption of regularity, and their reliance on the decision in *Calder Gravel Ltd v Kirklees Metropolitan Borough Council (1989) 60 P & CR 322* takes them nowhere. **1982* This is not

a case in which the original facts are lost in the mists of time, and in which the court relies upon an evidential assumption as to the original position based on the manner in which people have behaved subsequently. In this case, there is no evidential void for the presumption to fill.

255. In addition to the argument based on paragraph 3(4)(a), which I have upheld, the defendants ran a number of alternative arguments as to why it was said that the College lacked capacity to enter into the Contract. While on the basis of the finding I have reached on the borrowing issue, it is not necessary to resolve these alternative grounds of argument, in circumstances in which the points were the subject of argument I address the alternative grounds below.

The vires defence based on regulations 6 and 7 of SEYFER 2012

256. I have already referred to [SEYFER 2012](#), regulations made by the Secretary of State in exercise of the delegated legislative power provided for in various of the sections of the relevant primary legislation. The College, supported by the Council, submitted that it was ultra vires the school to spend funds from the Council's "school's budget" (for the purposes of [section 45A\(2\) of the SSFA](#)) on capital expenditure.

257. To the extent that the Contract was to be treated, for accounting purposes, as a finance lease, then I accept that it involved capital expenditure for the purposes of [SEYFER 2012](#), and that use of the local authority's schools budget for that purpose would not be in accordance with [regulations 6 and 7 of SEYFER 2012](#). I do not think Mr Straker for the claimants contended to the contrary. The factual basis, therefore, for the defendants' argument under [regulations 6 and 7 of SEYFER 2012](#) could only arise if, for some reason, the College did have capacity to take out a finance lease notwithstanding [paragraph 3\(4\) of Schedule 1 to the Education Act 2002](#), but then sought to meet payments due under that finance lease from monies emanating from the school's budget. I shall assume, for the purposes of considering this argument, that Mr Oldham for the College is right to contend that the restrictions on the use of funds in the delegated budget imposed by [regulations 6 and 7 of SEYFER 2012](#) apply to the College, even though [SEYFER 2012](#) is not directed to the College but to the Council.

258. [Regulations 6 and 7 of SEYFER 2012](#) are concerned with the use of funds emanating from a particular source, not with capacity to contract. The various statutory provisions under which the Regulations were enacted do not include those provisions of primary legislation which directly address the capacity and powers of maintained schools or even of local authorities. [SEYFER 2012](#) was passed many years after those provisions which do clearly define the powers of maintained schools first appeared in the [SSFA in 1998](#) (such that, if any part of those Regulations did limit the capacity of maintained schools, this occurred a number of years after those schools were first created and endowed with statutory capacity). Those matters have led me to conclude that [SEYFER 2012](#) does not impose limitations on the contracting powers of maintained schools, but, at best for the College, on the manner in which contractual obligations may be performed.

259. Further, the obligations imposed by [SEYFER 2012](#) are placed on the Council and not on the College. The College's position in closing submissions was as follows: ***1983**

"The College does not suggest that all the provisions of [SEYFER 2012](#) impose restrictions on its vires, although they certainly regulate the powers of the Council. As set out above, SEYFER is directly addressed to LAs ['local authorities'] and not GBs ['governing bodies']. They create a restriction on the vires of the GB only where the GB's actions constitute a circumvention of the detailed scheme of budgetary allocation and control in SEYFER. Where an LA cannot allocate in an individual delegated budget funds for capital expenditure, it cannot be permissible for the GB to use those funds for capital purposes."

260. Traditionally, the prohibition on performing a contractual obligation in a particular way only rendered a contract illegal as a matter of private law where the contract expressly required performance in that way, or where the shared intention of both parties was to perform the contract in that unlawful way. It has become more difficult to repeat those old certainties with confidence now that a factors-based approach to the issue of illegality falls to be applied following [Patel v Mirza \[2017\] AC 467](#), but the broader range of possible responses to illegality identified in that case would itself militate against treating the illegal nature of one party's anticipated method of performance of a contract which can be performed lawfully in some other way as something rendering the contract void for all purposes.

261. If an innocent intention (in the sense that there was no awareness of the illegality) to discharge contractual obligations using funds which could not lawfully be used for that purpose is sufficient to render the decision to contract (rather than the use of the funds) void as a matter of public law (an issue which was not the subject of submissions), in my view such a public law ground of invalidity would not give rise to a defence of lack of capacity to contract as a matter of private law. If the College was or became able to discharge its liabilities under the Contract using funds which were not subject to similar restrictions (such as funds from the YPLA, the two supporting dioceses or its own commercial activities), I cannot see why it should be relieved from liability merely because it could not use funds in the Council's schools budget for this purpose. Mr Oldham accepted in closing submissions that if, the day after the Contract was signed, the College had received funds from the dioceses to cover all of the hire payable, the Contract would not be outside the College's capacity to contract or void. That in itself strongly militates against the suggestion that [regulations 6 and 7](#) affect the College's capacity to contract.

262. In the course of closing argument, it became apparent that the College had pleaded an alternative to its "no contract" case, which asserted that even if the Contract was valid, the use of funds in the schools' budget to make payments under the Contract was not, such that these funds were said to be recoverable in unjust enrichment. In circumstances in which (on the evidence of Ms Williams of the College) all funds received by the College from whatever source were paid into a single bank account from which its expenditure was met, it is not clear how the factual predicate for this argument (that monies from the Council were used for an unlawful purpose) can be made out. There are also issues as to what happens if funds which cannot be lawfully used by the payer for a particular purpose (albeit this is unknown to the payee) are used to pay a debt arising under a valid contract. Is there a defence to the claim in unjust enrichment that the sum has been paid **1984* to discharge a valid debt and hence good consideration has been provided (*Goff and Jones, The Law of Unjust Enrichment* , 9th ed (2016), chapter 29 , [section 4](#))? Or can a claim in unjust enrichment by the payer to recover the sums paid be defeated by a defence of set-off based on the payee's debt claim? These issues were not the subject of submission and, in the light of my previous findings, it is not necessary to decide them. I therefore say no more about them.

The vires defence based on the contravention of the Council's Scheme

263. As I have mentioned, under [section 48 of the SSFA](#) the Council is required to issue the Scheme. The College and the Council contend that the powers of the College are "subject to" the provisions of the Scheme, such that (in private law terms) the College does not have contractual capacity to enter into a contract which does not comply with the terms of the Scheme. It is said that there was a failure to comply with the terms of the Scheme here because in entering the Contract, the College contravened the following provisions of the Scheme:

- (i) Para 2.1 which required a maintained school to manage its delegated budget with due regard to the Council's standing orders, contract standing orders and financial regulations, and to the exercise of budgetary and financial controls.
- (ii) Para 2.4 which required a maintained school to seek to achieve efficiencies and value for money, to optimise the use of its resources and to invest in teaching and learning, taking into account the authority's purchasing, tendering and contracting requirements.
- (iii) Para 2.10 which required a maintained school to abide by the Council's financial regulations and contract standing orders (including obtaining at least three tenders for any contract with a value exceeding £10,000 a year).
- (iv) Para 2.14 which required a maintained school to notify any use of its budget share for capital expenditure over £15,000 to the Council, and for decisions in relation thereto to take into account the advice from the director of finance or the director for children and young people.
- (v) Para 2.15 which provides that

"the authority may issue a notice of concern to the governing body of any school it maintains where, in the opinion of the director of finance and the director for children and young people, the school has failed to comply with any provisions of the scheme or where actions need to be taken to safeguard the financial position of the local authority or the school. Such a notice will set out the reasons and evidence for it being made and may place on the governing body restrictions, limitations, or prohibitions in relation to the management of funds delegated to it".

- (vi) Para 3.6 which provides that a maintained school is only permitted to borrow money with the written permission of the Secretary of State.
- (vii) Paras 4.5 and 4.9 which provide that any planned deficit budget is required to be approved by the Council and to be subject to certain limits, including a maximum length of three years, and a maximum deficit of £150,000. **1985*

Is the College's capacity to contract in private law circumscribed by the terms of the Scheme?

264. As I understand the position, schemes for financial delegation by local authorities to schools were first introduced by [Chapter III of the Education Reform Act 1988](#) (“the ERA”). The ERA provided for the Secretary of State to approve any scheme, and authorised a local authority to suspend a school's delegated budget if the school's governing body had been guilty of a “substantial or persistent failure to comply” with the requirements of the scheme ([section 37](#)).

265. At the times material to the present claim, the Scheme was issued by the Council pursuant to [section 48 of the SSFA](#) . [Section 48](#) provided that the Scheme would deal with “such matters connected with the financing of schools maintained by the authority” as the SSFA or regulations issued by the Secretary of State required. The description of the purpose of the Scheme is [section 48](#) is not immediately suggestive of a document whose contents will define the legal powers of a maintained school. However, Mr Oldham is able to point to other provisions of the SSFA and the [Education Act 2002](#) which provide a better basis for such an argument.

266. First, [section 50\(3\) of the SSFA](#) provides that a maintained school may spend its delegated budget as it sees fit “subject to any provision made by or under the scheme”. Those words are certainly capable of supporting an argument that compliance with the Scheme is a limit on one of the College's powers (viz how it spends its delegated budget), albeit that would not constitute a limit on the exercise of its power to contract (see the discussion of [SEYFER 2012](#) above).

267. Second, [paragraph 3\(8\) of Schedule 1 of the Education Act 2002](#) —the [Schedule](#) which sets out the powers of the statutory corporation constituted by a maintained school's governing body—refers to the paragraphs setting out the powers of the governing body and states: “Sub-paragraphs (1) to (3) have effect subject to— (a) any provisions of the school's instrument of government; and (b) any provisions of [the Scheme].”

268. The argument that paragraph 3(8) imposes a limit on the College's powers is a formidable one, but one which (at least in its fullest extent) I am unable to accept. In order to test the argument, I asked to see the College's instrument of government (a document which I was told there is no duty to publish but which, on the College's argument, limited its powers). It provided, inter alia:

“The school is to be conducted both as a Catholic school in accordance with the canon law and teachings of the Roman Catholic Church, and as a Church of England School, in accordance with the Trust Deed of the school and in particular ... at all times the school is to serve as a witness of Our Lord Jesus Christ.”

269. I put the example to Mr Oldham in argument of a contract by the College to hire a contraceptive dispenser. He did not shrink from the suggestion that, if this was contrary to the teachings of the Roman Catholic Church, the contract would be void on grounds of lack of capacity by reason of [paragraph 3\(8\)\(a\) of Schedule 1 to the Education Act 2002](#) . However, I cannot accept the suggestion that something as fundamental to a third party dealing with the College as the extent of the College's contractual capacity **1986* could turn on the resolution of theological disputes such as whether the Guelphs or the Ghibellines had right on their side.

270. There are similarly a number of provisions in the Scheme—a document which is 37 pages long—whose broad-textured and disputable nature makes them inherently unsuitable as limitations on the College's contractual capacity. For example para 2.4 provides that “schools must seek to achieve efficiencies and value for money, to optimise the use of their resources and to invest in teaching and learning” and that “it's important for schools to review their current expenditure, compare it to other schools and think about how to make improvements”. Para 9.1 requires the school to demonstrate when buying insurance that “the cover is relevant to the authority's interests and that it is at least as good as the relevant minimum cover arranged by the authority”.

271. The argument that only some provisions of the instrument of government and the lease impose limits on the College's power to contract, and not others, is itself an unattractive one, because of the uncertainty to which such an approach would inevitably give rise when determining which provision do or do not impose such a limit. Unless a particular paragraph of the Scheme itself makes it sufficiently clear that compliance with that provision constituted a limitation on the extent of the College's power, I would not regard any provisions of the scheme as limiting the College's capacity, so much as imposing obligations on the College vis-à-vis the Council as to how it should conduct itself. A distinction of this kind bears some relationship to the distinction drawn in private law between “want of authority” and “abuse of authority” which was referred to by Millet J in

Macmillan Inc v Bishopsgate Investment Trust plc (No 3) [1995] 1 WLR 978 , 984 or between validity and propriety referred to by Stuart-Smith LJ in *Grupo Torras SA v Sheikh Fahad Mohammed Al-Sabah* [1995] CLC 1025 , 1033.

272. Similarly, in private law, the courts have been reluctant to allow the internal procedures of a company to serve as a constraint on the authority of the company's agents to enter into contracts which are of a kind permitted on the face of its foundational documents (the rule in *Royal British Bank v Turquand* (1855) 5 E & B 248). A similar concern not to make the validity of contracts between third parties and a public body over-dependent on the internal workings of the public body can be seen in a number of cases involving public bodies. For example in *Charles Terence Estates* [2012] PTSR 790 , para 64 Cranston J directly invoked the *Turquand* principle when saying that “in general a public authority making a contract in breach of internal rules and procedures should not be able to invoke these when they are not readily visible to the counterparty and the counterparty has acted in good faith”.

273. These matters suggest a degree of caution in approaching the College and the Council's argument that the terms of the Scheme set limits on the College's capacity to contract. Further, the following provisions of the Scheme support the view that it is generally concerned with the relationship of the Council and College inter se rather than the power of the College when dealing with others:

(i) Under the heading “the role of the scheme”, the Scheme provides that “this scheme sets out the financial relationship between the authority and the maintained schools which it funds” and that “the requirement of the *1987 Scheme in relation to financial management and associated issues are binding on both parties ” (emphasis added). This is consistent with the view that the Scheme is generally concerned with setting out the rights and responsibilities of maintained schools and maintaining authorities “inter se” rather than provisions which limit the power of a school to conclude contracts with third parties.

(ii) The general sanction which the Scheme provides for non-compliance with its terms is (a) the issue of a notice of concern by the Council in respect of a failure to comply with any provision of the Scheme, which allows the Council to impose various requirements on the school's staff and governing bodies such as extra training (para 2.15), and (b) the suspension of the school's right to a delegated budget in the event that the provisions of the Scheme “have been persistently breached or if the budget has not been managed satisfactorily” (para 1.1). The stipulated consequences for non-compliance, therefore, all involve consequences for the College rather than the invalidity of transactions.

274. I will now review the specific paragraphs of the Scheme relied upon by the College and the Council in closing argument to consider whether any of them are in such terms or of such a nature as to give rise to limits on the College's capacity to contract. It is right to note that only limited time was devoted at the hearing to exploring these underlying complaints, whether in cross-examination or submission.

Paras 2.1.1, 2.4 and 2.10: failure to comply with the Council's standing orders as to contracts

275. Para 2.1.1 required the College to manage its delegated budget “with due regard to the instructions laid out under the local authority's standing orders as to contracts” and para 2.4 provided that schools had to seek efficiencies “taking into account the authority's purchasing, tendering and contracting requirements”. While I would not regard the phrases “with due regard to” and “taking into account” as phrases limiting the College's capacity to contract, the language of para 2.10 is more emphatic. Para 2.10 states that the College is “required to abide by the authority's financial regulations, standing orders in respect of purchasing, tendering and contracting matters” and that “all contracts let by a school for more than £10,000 in any one year must be subject to at least three tenders”. For contracts with values of £3,834,411 and above (works) and £153,376 and above (goods and services), the procurement process required invitations to tender to be issued in accordance with EU Procurement Directives.

276. The contract standing orders document states that “this is an important document that forms part of the Council's constitution. Compliance by all members and staff is therefore mandatory and contravention is a serious matter”.

277. I accept that the College's decision to enter into the Contract did not comply with the Council's standing orders. Indeed no attempt was made by the claimants to establish that it did. However, I do not accept that the effect of such non-compliance was to render the Contract beyond the capacity of the College or otherwise void. Had the Contract in question been with the Council, section 135(4) of the Local Government Act 1972 would have applied. This provides: *1988

“A person entering into a contract with a local authority shall not be bound to inquire whether the standing orders of the authority which apply to the contract have been complied with, and non-compliance with such orders shall not invalidate any contract entered into by or on behalf of the authority.”

278. I accept that, given my conclusion that (section 49(5) notwithstanding) it was the College, and not the Council, which was the putative contracting party, it might be said that section 135(4) does not apply to the Contracts on its own terms because the claimants are not “a person entering into a contract with a local authority”. However, in circumstances in which the contract standing orders do not limit the contractual capacity of the Council, it would be strange if they had this effect when applied to the College through the Scheme. Taken together with the other matters I have referred to which have led me to reject the argument that the Scheme operates generally as a limit on the College's vires, I have concluded that compliance with the standing orders does not constitute a legal limit on the College's power to contract, albeit that as between the Council and the College inter se, they regulate how the College should exercise its powers. As the College and the Council's defence based on the Scheme was advanced solely on an ultra vires basis, and not, for example, on the basis that the claimants were aware of the College's non-compliance with the standing orders, that is sufficient to reject this defence to the claim under the Contract.

Para 2.4: failure to manage the delegated budget with due regard to the financial regulations

279. The Council's financial regulations are a 49-page document whose purpose is stated to be to “provide a framework for managing the authority's financial affairs”. On their face, they do not apply to maintained schools. Para 1.1.5 provides that “schools with delegated budgets are subject to a separate framework of regulation”. It is no doubt for this reason that the financial regulations do not have direct application to the College, but are a matter to which College must have “due regard” by reason of para 2.1.1 of the Scheme.

280. The provision of the financial scheme relied upon by the College and the Council is para 1.3 which contains a “statement of principles”. This records that the council “expects high standards of conduct from its members and officers”, and there follows a series of high level statements of principle, including references to the Council's expectation of “high standards in financial management and administration”, that “the planning, monitoring and control of the use of resources is of vital importance” and that “value for money is at the core of the council's financial activity”. Finally, para 1.3.2 provides:

“The principles of sound financial management, proper exercise of responsibility, and accountability, as set out in financial regulations, should be applied in all circumstances, even where any particular circumstance is not specifically referred to.”

281. It will be apparent that the provisions relied upon are of uncertain and highly disputable scope. Taken together with the way in which the financial regulations are referred to in the Scheme (“with due regard to”) and the **1989* factors I have identified as tending against the suggestion that the Scheme generally operates as a limitation on the College's vires, I have concluded that para 1.3 does not limit the College's capacity to enter into contracts. Rather it is one of a number of provisions which relate to the College's exercise of that power as between the College and the Council inter se.

282. I received relatively limited submissions on which aspects of the financial regulations it was said that the College had failed to have “due regard” to. The sum total of what was said in the College's closing submissions on this topic was:

“Para 1.3 of the Council's financial regulations ... sets out the general principles of sound financial management to safeguard public funds ... Seen as a whole, and for all the reasons advanced in these submissions, the Council fell well short of those standards.”

283. For reasons which I explain below when addressing the College and the Council's submissions on the *Roberts v Hopwood* and *Wednesbury* duties I accept that the College proceeded with the Contract without any adequate attempt to ascertain the affordability of the project from the College's resources, and without taking sufficient steps to seek to ensure that the Contract represented value for money. If, therefore, I had concluded that the requirement to have “due regard to” the financial regulations

gave rise to a limit on the College's capacity to contract, I would have concluded that that limit was not satisfied in relation to the entry into the Contract.

Para 2.4: failure to seek efficiencies and value for money

284. Para 2.4 of the Scheme provided that:

“Schools must seek to achieve efficiencies and value for money, to optimise the use of their resources and to invest in teaching and learning, taking into account the Authority's purchasing, tendering and contracting requirements.”

Essentially for the same reasons which led me to conclude that the reference in the Scheme to the financial regulations did not limit the College's power to contract, I have concluded that this provision does not create a limit of the College's contractual vires, but that, if it did, that limit was not satisfied.

Para 2.14: failure to inform the Council of capital expenditure and related failures

285. Para 2.14 provides:

“Governors are required to inform the authority if the expected capital expenditure to be met from the budget share is likely to exceed £15,000, and to take into account any advice from the director of finance and director for children and young people as to the merits of the proposed expenditure.”

286. There is a brief suggestion in the Council's opening, and an even briefer reference back to that reference in the Council's closing, that the College failed to comply with this provision, and that, in those circumstances, the College lacked capacity to enter into the Contract. In circumstances in which the classification of the Contract as one of capital expenditure entails **1990* that the Contract constituted a finance lease and, hence, borrowing, it is not necessary to address the position if the Contract had, notwithstanding its status as capital expenditure, been binding on the College apart from para 2.14.

287. My provisional view is that a failure to inform the Council of the proposed expenditure in compliance with para 2.14 would not deprive the College of capacity to contract. Under the statutory scheme for funding secondary education, the incurring of capital expenditure is principally a matter for the maintained school and not the Council. The purpose of the notification provision appears to have been to allow the directors of finance and children and young people to give non-binding advice on the merits of the proposal, and the Council's permission is not required for the College to proceed. These matters all militate against para 2.14 constituting a limit on the College's power to contract.

288. So far as the factual position is concerned while the College did inform the Council of the proposed expenditure under the Contract, they did so expressly on the basis that this was *not* capital expenditure. I would not regard this as compliance with the para 2.14 obligation.

Para 3.6: borrowing without the permission of the Secretary of State

289. I have already addressed the substance of this complaint in the context of [paragraph 3\(4\) of Schedule 1 to the Education Act 2002](#) , and concluded that, as a finance lease, the Contract fell outside the contractual capacity of the College as a statutory corporation because it involved borrowing without the permission of the Secretary of State. In my view, para 3.6 of the Scheme is not intended to enlarge upon or vary the content of [paragraph 3\(4\) of Schedule 1](#) , but simply to restate it. I note that the guidance on the content of local authority schemes issued by the Secretary of State under [section 48 of the SSFA](#) , which the Scheme tracks closely, provides that “the scheme should contain a provision *reminding* schools that governing bodies may borrow money (which includes the use of finance leases) only with the written permission of the Secretary of State” (emphasis added). Accordingly this paragraph of the Scheme adds nothing to [paragraph 3\(4\) of Schedule 1](#) .

Para 4.9 of the Scheme: the size and duration of the College's deficit

290. Para 4.9 of the Scheme provides:

“The maximum length for which a deficit may last will be three years. The granting of a licensed deficit would normally be in circumstances of an increasing pupil number base, or the financing of an approved development at the school. A deficit will only be licensed if the school has a viable financial plan for repayment. The maximum deficit allowed will be 10% of the school budget share or £150,000, whichever is less.”

291. The College and Council contend that this provision was not complied with because, when it entered into the Contract, the College had been operating at a deficit since it was constituted in 2008/2009, and therefore for more than three years, and because its deficit had exceeded £150,000 from the end of the 2009/2010 year and had reached £760,000 by 2011/2012. It is not clear to me how the failure to comply with the deficit requirements in the Scheme (either as to duration or amount) is said to impact **1991* the vires of the College to contract: for example whether it is said that once the budget deficit exceeds the stipulated amount or duration, all contractual capacity ceases (or at least all contractual capacity to conclude contracts under which it would fall to the College to make payments) until the budget has been eliminated (if it has continued for over three years) and/or been brought back below £150,000. Nor was it clear to me what the College and Council alleged would be the consequence if the College became non-compliant with the deficit provisions during the life of a contract.

292. It is obvious that this provision cannot sensibly be treated as a limitation on the College's capacity to contract. The argument becomes even more difficult in this case, in circumstances in which the Council licensed the College's deficit in an amount and for a duration exceeding those specified in para 4.9 of the Scheme in January 2012 and thereafter. In circumstances in which the role of the Scheme is said to be to “set out the financial relationship between the authority and the maintained schools which it funds”, and in which para 4.9 provides that the Council is to license deficits, the suggestion that a deficit licensed by the Council in duration and amount may nonetheless lead to contracts which the College purports to conclude being void has little to commend it.

The allegation that the contract was entered into with an improper purpose

293. It is clear that one ground of public law unlawfulness which may arise in respect of a decision of a public body (including a decision to contract) will be where the decision was taken for the purpose of frustrating a statutory purpose or constraint which applies to the public body. In *Padfield v Minister of Agriculture, Fisheries and Food [1968] AC 997* a statute gave the minister a discretion to refer complaints for investigation by a committee, the statutory purpose of that provision being to provide a machinery for investigating complaints by farmers. The House of Lords rejected the argument that the minister had an unfettered discretion not to refer complaints, on the basis that the discretion had been conferred to promote the policy and objects of the Act. In that case, the discretion could not be exercised so as to prevent something happening which it was the object and purpose of an Act of Parliament should happen in appropriate circumstances.

294. The same issue can arise, in more acute form, where the purpose and effect of an Act of Parliament is that something should not happen at all, and a public body seeks to exercise powers to achieve the same outcome by another route. In *Crédit Suisse [1995] 1 Lloyd's Rep 315* Colman J considered the position if, contrary to his decision, the council did have statutory powers to do what it did, but had acted with the purpose of avoiding annual borrowing and spending limits on local authorities and so as to be able to trade in timeshare units which a local authority did not have power to do. He held that this made the decision to contract (and the contract) invalid, on the basis that the decision to contract had been taken on the basis of an irrelevant consideration (viz the desire to evade those limits).

295. That conclusion was upheld in the Court of Appeal [1997] QB 306. Neill LJ (at p 334) did not found his decision on this issue on the fact that the council had taken account of improper considerations, but because, Parliament having put in place “an elaborate structure to provide for and regulate the manner in which a local authority can obtain funds to **1992* carry out its statutory functions”, it could not be a proper purpose for the Council “to circumvent the restrictions on borrowing and spending”.

296. In this case, the College and the Council contend that even if it was within the power of the College to enter into the Contract, its decision to do so was void as a matter of public law (with the consequence, it is said, that the College lacked

capacity to contract as a matter of private law) because “the terms of the Contract were driven by the requirement of BOS Hire that they be precisely fashioned so as (as BOS Hire thought) to avoid the bar on borrowing”. In closing, the College put its case on this issue as follows:

“On the undisputed evidence the terms of the contract and the structure of the deal were generally fashioned by Mr Spring so (as BOS Hire thought) as to avoid the ban on the College borrowing. Mr Spring’s evidence was that he sought to draft the Contract to ‘satisfy all of the operating lease tests’ ... If it is not borrowing, it is a circumvention of the restriction on borrowing in the same way that *Crédit Suisse* was and it is, accordingly, ultra vires the College’s power to agree it.”

297. Some care is required when seeking to apply the improper purpose ground of public law challenge where it is alleged that (in effect) the public body had wanted to do X but, having ascertained it had lacked the power to do so, had resolved to do Y as the next best thing. If a school had wanted to provide transport for its students, and on ascertaining that it lacked the power to borrow money to buy minibuses, had resolved to use its funds to hire them as and when needed instead, it could not be suggested that this decision was ultra vires because it had been motivated, in part, by the desire to provide by an alternative method the transport which the Council lacked the power to provide on its preferred approach. Similarly, if a public body could not enter into a lease in excess of a certain duration because this would amount to capital expenditure, it could not be suggested that the decision to enter into a lease of a sufficiently short duration not to be susceptible to that characterisation was an impermissible attempt to evade the statutory limitation.

298. In the present case, I have concluded that the prohibition on borrowing without the permission of the Secretary of State requires a substantive test, such that a lease which is, for IAS 17 purposes, a financial lease will be caught by the prohibition. IAS 17 is itself a provision which requires the determination of the nature of the lease to be undertaken as a matter of substance and not form. If, contrary to my findings, I had reached the conclusion that the Contract was an operating lease, in circumstances in which there is no relevant statutory restriction on the College’s power to enter into an operating lease, the decision to enter into such a lease could not fairly be characterised as an attempt to evade the statutory prohibition on borrowing or entering into finance leases, because the transaction which the College had entered into would, ex hypothesi, be substantively different to the transaction which the statutory scheme prohibited. Nor could it matter, for this purpose, if the terms of the Contract had been drafted with a view to ensuring, as a matter of substance, that it was not a finance lease: for example making it clear that it included no right of purchase for the College, or limiting the duration of the lease so that the lessor retained a significant interest in the Building. On those facts, the decision to enter into the lease **1993* would not have been an attempt to achieve indirectly the same substantive outcome which the College had no power to achieve directly, but a decision not to enter into a type of transaction which statute prohibited, but to enter into a substantively different transaction which the statute allowed.

299. Had I concluded, therefore, that the Contract was an operating lease and not a finance lease, I would have rejected the College and the Council’s submission that the decision to enter into the Contract was nonetheless unlawful because it was undertaken for the improper purpose of circumventing the prohibition on entering into finance leases. In these circumstances, it is not necessary to address, on the specific facts of this case, the legal issue which I have discussed above as to the circumstances in which such an improper purpose may provide a basis for resisting a claim under a contract as a matter of private law.

Roberts v Hopwood and irrationality

300. I can take these two defences together.

301. It has been established since *Roberts v Hopwood [1925] AC 578* that

“a local authority owes a fiduciary duty to the ratepayers from whom it obtains moneys needed to carry out its statutory functions, and that this includes a duty not to expend those moneys thriftlessly but to deploy the full financial resources available to it to the best advantage”: *Bromley London Borough Council v Greater London Council [1983] 1 AC 768*, 829 (Lord Diplock).

A decision to expend money in breach of that duty will be void as a matter of public law. The description of that duty as “fiduciary” is not a direct invocation of the private law concept of fiduciary duty, but one which draws an analogy with the

private law obligations of stewardship of a trustee, reflecting the fact that those approving expenditure by a public body are not dispensing their own funds, but public funds.

302. Breaches of that duty have been found when a local authority agreed to pay wages in excess of the market rate with a view to providing employment (*Roberts v Hopwood* itself), or to levy a supplementary rate to subsidise public transport (*Bromley*) or to accept a lower offer from tenants than from another potential buyer when selling public property (*R (Structadene Ltd) v Hackney London Borough Council* [2001] 2 All ER 225).

303. In addition, it is, of course, well established that a decision will be invalid in public law if it is unreasonable in the *Wednesbury* sense. This will often overlap with the issue of whether there has been a breach of the *Roberts v Hopwood* duty. For example, in *Structadene* Elias J found that the council had acted in a *Wednesbury* unreasonable way “for essentially the same reason” as he found that the *Roberts v Hopwood* duty had been breached, namely that “a rational council would not have rejected an offer which was £100,000 more favourable than the offer which it in fact accepted” (p 235).

304. The evidence on this aspect of the case developed in a somewhat unsatisfactory way. The witnesses relevant to the issue of whether the College had acted irrationally and in breach of the *Roberts v Hopwood* duty were Mrs Goodhead, the principal at the relevant time, and Ms Williams, the business manager. However, in circumstances in which the College was, in effect, seeking to establish its own irrationality, the College had no incentive *1994 to seek to establish that those individuals or the other members of the College staff and governing body had acted in accordance with the College's public law duties in this respect. This forensic difficulty is inevitable in the unusual case in which a public body seek to establish the unlawfulness of its own decision-making process. For that reason, I have carefully considered whether there are any matters, which did not emerge during the oral evidence, which could be relied upon in support of the argument that the decisions were lawful. However, the essential facts appear relatively clearly.

305. It is clear that those acting for the College in decisions relating to the Contract did so from a profound personal conviction that it was not simply desirable, but essential, to have a sixth form centre, both for the educational well-being of the College, and more completely to fulfil the College's mission of providing Christian secondary education on the Isle of Wight. I also accept that the same individuals held the strong view that the Council was, in effect, under a moral obligation to provide the funding for the sixth form building, both to fulfil its original decision that the age range of the College should be expanded to include a sixth form, and so as to treat the College fairly and equitably when compared with the treatment of other Isle of Wight schools. I am not in a position to pass any comment on how far, if at all, these views were justified, but it was clearly a factor which was a powerful driver of decision-making within the College at the relevant time.

306. However, as custodians of public funds, it was not appropriate for the College to enter into and then enlarge the scope of this very significant legal commitment without determining that it had or would have sufficient resources to meet its commitments on the basis of a Micawberesque hope (or in this case conviction) that something would turn up. This was essentially the approach which the College adopted.

307. The process by which the Contract was concluded involved almost no effort by the College to ascertain whether the price quoted by BOSHire represented good value. The College's own assessment appears to have been that the costs of the proposal were high (as noted at a meeting of the finance committee on 2 February 2012), but that this represented the only means of proceeding with the project within the desired timescale. Ms Williams confirmed in her evidence that “we felt it was a very expensive way of obtaining a building. I certainly was very aware it was public money we were using and I felt it was a very expensive way of going about it”.

308. At no stage did the College consider whether the construction of the sixth form remained a viable proposition when funding alternatives fell away (for example following the cancellation of the “Building Schools for the Future” programme in 2010). When the BOSHire proposal came in, the College did not revisit two earlier and significantly cheaper proposals for the construction of modular buildings (from Building Schools for Nothing and the McAvoy Group). Ms Williams, giving evidence for the College, stated that she knew of “no good reason the College did not go back” to those “significantly cheaper proposals”. The documents before me offer no such explanation, and my conclusion is that having concluded that the BOSHire proposal was likely to achieve a sixth form building more quickly than other options, the College decided to continue with BOSHire come what may, even when planning permission issues delayed the construction of the Building until after September 2012, and after it became apparent that the costs of the BOSHire proposal substantially exceeded those previously quoted. *1995

309. The College's determination to proceed with BOSHire is manifest in a number of matters:

(i) The absence of any serious attempt to reduce the cost of the BOSHire proposal in commercial negotiations, even when it became apparent that terms which Mr Blow of BOS had originally indicated would feature in the final contract such as a legally enforceable right to purchase would not form part of any deal.

(ii) The College's decision to move on 6 December 2012 from a phased implementation of the programme to the immediate implementation of the full proposal in 2013, with limited consideration of the financial implications of such a significant change beyond generalised assertions that the principal and business manager were confident that a whole build could go ahead.

(iii) The College's decision that BOS should undertake substantial work on site not only before the Contract was signed (by which point £484,000 of work had been done), but before planning permission had been obtained.

(iv) The failure to revisit the proposal as further costs not originally budgeted for emerged. This had happened even before BOSHire had signed the Contract, when on 18 March 2013 the College informed the Council that “we are finding it very difficult to provide the necessary finances from our budget to fully equip and refurbish the new building”. These and other unbudgeted costs led to the two variations to the Contract when these amounts were rolled into higher annual payments over the 15 years of the Contract's duration.

310. In 2017, Ms Elizabeth Goodwin, the Council's chief internal auditor on secondment from PwC, produced a report which provides a fair assessment of the contracting process undertaken by the College. Among other things, it concluded that:

(i) Key known or estimated costs for the sixth form were not included until the Contract was effectively committed to.

(ii) Assumptions were not stress-tested and there was no robust financial planning.

(iii) There was little questioning of the “prevailing view to provide sixth form education at the College initially, and thereafter little evidence of scrutiny of the financial impact of doing so”.

311. In effect, the College had “tunnel vision” in its determination to provide the sixth form centre it felt the College, its pupils and the island community so badly needed, which led it to suspend any critical judgment so far as the value, affordability or viability of the BOSHire proposal was concerned, and to keep going on its current path whatever further setbacks manifested themselves. The attitude of the whole Governing Body is captured in the e-mail which Mrs Goodhead sent to Ms Williams on 21 January 2013, a document frequently quoted by the defendants but nonetheless informative for that: “we can't not let this happen obviously”.

312. The liabilities under the Contract as originally signed involved total payments over the 15-year term of £10,017,615, something which was projected to result in a deficit at the end of the first year of £744,620. There was no evidence before me of any serious attempt by the College to satisfy itself that the cost of the Contract could be met from its own resources. A finance committee meeting of 6 February 2013 anticipated difficulty in meeting the lease payments, and it is not apparent what, other than a Panglossian outlook, led to the conclusion at the full Governing Body *1996 meeting a week later that the Contract could be signed and that the Council was “happy” with the budget recovery plan.

313. The evidence of Ms Williams, the College business manager, in cross-examination was that from the outset, the College's finances were looking “bleak and difficult” and that when the Contract was signed, it was already “unaffordable” from the College's own resources. Mrs Goodhead explained that the Governing Body “believed all the way through that we would eventually get support, they did feel that there was an unevenness in the local authority's support”. As she explained in another passage in her evidence (when referring to funding another school had received): “It begins to explain why the governing body continued to believe that the right—the truth would out, as it were, and we would receive appropriate funding, equal to other schools.” She accepted that the matters which led the College to revise its budget in October 2013 were matters which the College was well placed to know when the Contract was signed.

314. The incurring of substantial liabilities with no realistic expectation of paying for them absent some significant change in circumstances which there is no reason to suppose will occur is not consistent with the College's quasi-fiduciary duties in respect of the expenditure of public funds, nor did it fall within the range of reasonable decisions which a body in the position of the College might take. It follows that the College's decision to enter into the Contract, and to agree the two variations to the Contract, was in breach of its *Roberts v Hopwood* duty and was also unreasonable in the *Wednesbury* sense.

315. In making these findings, it is important to note the good faith with which the Governing Body and the relevant members of the College staff acted throughout. It is also important to record the difficult position they found themselves in. The College was under a duty to implement the statutory proposal to expand the College's age range under [paragraph 40 of Schedule 3 to the School Organisation \(Prescribed Alterations to Maintained Schools\) \(England Regulations\) 2007 \(SI 2007/1289\)](#). To do so,

and to meet the expectations of students, parents and staff, it concluded that a sixth form centre was required. However, it did not have access to the funds necessary to fund and construct one. This was an unenviable dilemma.

316. For the reasons I have set out above, I have concluded that the breaches of these two public law duties do not have the effect that the College lacked capacity to enter into the Contract, which is the only private law defence advanced. In particular, no case was advanced by the defendants that the claimants knew that the College was entering into the Contract in breach of these public law duties, and it is not therefore necessary to determine what the private law consequences of these public law breaches of duty might be. However, it is worth nothing that, to the extent that the public law duties reflect an obligation of care, they would not equate to a private law fiduciary duty (*Bristol and West Building Society v Mothew* [1998] Ch 1). In *Charles Terence Estates* [2013] PTSR 175 , para 18 Maurice Kay LJ doubted that the findings of the breach of *Roberts v Hopwood* duty in that case if “[transposed] to the private corporate sector ... would be characterised as a breach of a company director's fiduciary duties—more a matter of his duty of skill and care”. Knowledge that the servant or agent of the contracting counterparty was not acting with reasonable skill and care when committing its principal to the contract does not provide a basis *1997 for impugning a transaction (*LNOC Ltd v Watford Association Football Club Ltd* [2013] EWHC 3615 (Comm) at [64]). It is not necessary to decide whether a different consequence should follow where the counterparty is a public body, but there does not appear to be any compelling reason why it should.

Lack of statutory authority

317. The College advanced a further argument that the Contract, and the two variations to the Contract of June and September 2013, were not entered into in accordance with the College's Scheme of government with the result that the entry into the Contract was unlawful and void.

318. [Regulation 16 of School Governance \(Procedures\) \(England\) Regulations 2003](#) (SI 2003/1377) empowers the governing body to delegate any of its functions to a committee, a governor other than the head teacher or the head teacher (dependent on the nature of the function). It does not provide any particular method of delegation, but does require the governing body to review the exercise of delegated functions annually. With effect from 1 September 2013, provision to similar effect was made by [regulation 18 of the School Governance \(Roles, Procedures and Allowances\) \(England\) Regulations 2013](#) (SI 2013/1624).

319. The College produced a document called *The Statement of Roles and Responsibilities, Financial Terms of Reference and Scheme of Delegation* (“the Scheme of Delegation”) which set out the terms of reference and roles of various committees and of the principal. It was not clear on the evidence whether this was a public document or not, but it was not suggested that it was a document of which the claimants were or ought to have been aware.

320. The Scheme of Delegation identified the key responsibilities of the Governing Body as including the “authorisation of non-budgeted expenditure and virements subject to the limits in [section 2](#)”. The responsibilities of the finance committee included: (i) “to review tenders received for contracts, up to the limits in [section 2](#)”, to agree on which contractors are to be awarded contracts and to make recommendations to the full governors meeting; (ii) to authorise expenditure as per limits set out in [section 2](#); (iii) to receive requests for authorisation to vire expenditure between budget headings as per limits set out in [section 2](#); and (iv) “to review these terms of reference annually and propose any amendments to the Governing Body”.

321. The role of the principal as set out in this document included “[amending] the budget by virement between any budget headings up to the limits set out in [section 2](#)” and “[authorising] the purchase of individual items up to the limits indicated in [section 2](#)”. [Section 2](#) sets out a series of activities, and the relevant levels of responsibility of different persons or bodies in relation to those activities. The activity “authorisation of expenditure over £60,000” has an entry only against the full Governing Body which says, “with the director of finance”. There is no reference to a single governor being able to exercise any particular powers. [Section 2](#) also states as follows:

“Authorisation of Revenue and Leasing Contracts	All revenue and leasing contracts should be entered and authorised as per the LA Scheme for Financing Schools *1998
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“ ... At all times, the principles of best value will apply, as per the schools *best value statement* dated ...”

322. Mr Oldham for the College submitted that the Scheme of Delegation was not complied with: (i) in relation to the signature of the Contract in 2013, because there was no consultation with the director of finance; (ii) in relation to the June and September 2013 variations to the Contract, because they were signed by the chairman of the Governing Body without a decision being taken by the full Governing Body; and (iii) because the Contract and the variations were not in accordance with the Scheme and did not achieve best value.

The non-involvement of the director of finance

323. It is clear that the director of finance of the Council was not involved in the College's decision to enter into the **1999* Contract. As I have set out above, the mutual understanding of the College and the Council was that the decision to enter into the Contract was a matter for the College, and was not the responsibility of the Council.

324. Does the fact that the decision to contract was taken without the involvement of the director of finance constitute a breach of the Scheme of Delegation? I have concluded it does not:

(i) First, the words “with the director of finance” presuppose the involvement of the director of finance, but do not make the approval of the director of finance a precondition to the Governing Body's authority to authorise expenditure over £60,000.

(ii) Second, if the involvement of the director of finance was a condition of the Governing Body's authority, it would effectively disable the Governing Body from entering into contracts of this kind if, for any reason, there was no director of finance for a period or if the director of finance took the view that the issue was a matter for the College. It would take clear words to achieve this outcome, assuming it is possible to achieve it at all. In particular, neither [regulation 16 of the School Governance \(Procedures\) \(England\) Regulations 2003](#) nor [regulation 18 of the School Governance \(Roles, Procedures and Allowances\) \(England\) Regulations 2013](#) contemplate the Governing Body being able to delegate its functions to someone outside the College or to provide a veto to such a person.

(iii) Third, it is clear from the terms of the Scheme of Delegation that the Governing Body can themselves amend or vary the Scheme. In these circumstances, it must remain open to the Governing Body to dispense with the involvement of the director of finance if it thinks fit, particularly where the position of the Council is that the decision to contract is a matter for the College. The power to contract is a power of the Governing Body. It is not a power that the Governing Body should too readily be assumed to have subjected to a third party veto. The position is different from that which arises when two parties to a contract constrain their subsequent freedom to vary the terms of their contract without meeting certain formalities (as considered in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2019] AC 119*) because the Scheme of Delegation was adopted, and could be varied, by the unilateral decision of the Governing Body.

(iv) Fourth, the Council (through Mr Beynon's letter of 14 February 2013) confirmed the Council's approval of the College's decision to enter into the Contract. In circumstances in which the director of finance reported to the chief executive, it would be particularly surprising if the Contract was not binding because the director of finance had not been consulted, when the College had obtained the approval of a more senior executive within the Council.

325. For these reasons, I reject the College's argument that the decision to enter into the Contract in its original form involved a breach of the Scheme of Delegation.

The June and September 2013 variations

326. For the purpose of addressing this part of the College's argument, it is convenient to repeat some of my findings on the process by which the Contract and the two variations to it came to be signed.

327. On 13 February 2013 a full meeting of the Governing Body approved the College's decision to enter into the Contract and authorised Mr Lisseter to sign both the Contract and the College's Letter. The College's Letter confirmed that the Governing Body had authorised the execution and performance of the Contract. It stated that Mr Lisseter was “duly authorised on behalf of the Governing Body”. The Contract which Mr Lisseter was authorised to sign recorded that modifications of the Contract would have to be in writing.

328. As I have mentioned, it became apparent that the construction of the sixth form centre would involve additional costs over and above those allowed for within the Contract signed on 30 April 2013. An e-mail from Ms Williams to Mr Pierce of 10 May 2013 asked “when would you need confirmation of whether or not governors would want this rolled into hire costs?”. There is no record of the governors’ approving the decision to roll these costs into the Contract, but a variation to this effect

was signed by Mr Lisseter on 5 June 2013. The minutes of the Governing Body meeting of 18 July 2013 do not refer to the first variation, but do refer to “surprising additional requirements” for the Building “as already discussed”, and express the hope that the Council would pay for them. These costs were covered by the second variation of the Contract which Mr Lisseter signed on 5 September 2013.

329. There was a meeting of the Governing Body of 3 October 2013 at which the College's licensed budget plan was approved. No copy of the minutes of that meeting has been produced, nor of any of the papers which Mrs Goodhead confirmed were circulated in advance of such meetings. However, a letter from Mrs Goodhead to Mr Burbage of the Council dated 21 October 2013 suggests that the revision to the budget reflected the increased cost of the Building. The letter stated:

“Regrettably, the College's previous plan is no longer achievable, mainly, but not exclusively, due to the additional expenditure associated with the sixth form centre. Therefore, the College would like to accept the local authority's kind offer to extend the licensed deficit.”

330. Some of those costs featured in discussion with the Council on 4 April 2014 when the College's budget deficit came under discussion.

331. Mrs Goodhead gave evidence that, to the best of her recollection, she did not receive or was not aware of the June and September 2013 variations to the Contract, and that they were not discussed with the College before *2000 Mr Lisseter signed them. She was not cross-examined on this evidence. The College's other witness, Ms Williams, gave evidence that she was not aware of legal advice being taken prior to the signature of the two variations, but other than that she said nothing about them. She was not cross-examined on this topic.

332. While I accept that her evidence was given in good faith and represented Mrs Goodhead's best recollection some six years later, I have concluded that Mrs Goodhead's recollection is likely to be mistaken and that the full Governing Body are likely to have become aware at some point that increased costs had arisen after the preparation of the budget, that attempts to raise alternative funding for these costs had failed, and that they had been rolled into the Contract through the two variations as a result:

- (i) Mrs Goodhead was clearly aware in 2013 that additional costs had arisen which needed to be provided for, and in my view it is likely that she was aware of the decision to roll these into the Contract. Her own evidence was she worked closely with Ms Williams as the business manager.
- (ii) The revisions to the budget in October 2013, which resulted in part from the increase in costs reflected in the two variations, are likely to have been considered by all of the governors. This would inevitably have involved some discussion of the fact that the College had now agreed to pay larger hire instalments than when the budget was originally drawn up.
- (iii) The decision communicated in the College's letter of 21 October 2013 to accept the Council's offer to increase the amount of the licensed budget deficit is also likely to have been reached with the approval of the full Governing Body after discussion.
- (iv) The College have produced no minutes or evidence of what was discussed at that meeting, nor adduced any evidence as to what was said at it.
- (v) It would be very surprising if Mr Lisseter, who (as chairman of the Governing Body) had signed the two variations to the Contract to accommodate unbudgeted costs which had contributed to the revision of the budget in October 2013, had never mentioned that fact to the full Governing Body, not least at the October 2013 Governing Body meeting when the revised budget was approved. Certainly I would not be willing to find that Mr Lisseter had not informed the full Governing Body of these obviously material matters without a much more secure evidential base than Mrs Goodhead's uncorroborated recollection some six years after the event.
- (vi) Mrs Goodhead confirmed that in 2017, the Governing Body remained committed to honouring the Contract. In my view it is highly unlikely that, by this date, the full Governing Body was not aware of the revisions to the amounts payable under the Contract effected by the two revisions (and, as I have mentioned, no member of the Governing Body was called to suggest otherwise). If Mr Lisseter (who remained on the Governing Body until February 2018) had signed the two variations increasing the amounts payable under the Contract without this coming to the knowledge of, and being approved by, the full Governing Body before 2017, it is inevitable that the issue would have surfaced and left its mark at this point.
- (vii) Not only is there no evidence that it did so, but there was no suggestion in the College's pre-action correspondence that Mr Lisseter had signed either variation without authority. The College's position was to the contrary effect: Stone King's letter of 9 April 2018 stated “on 5 June 2013 *2001 and 5 September 2013, our client entered into two supplemental contracts with you”.

333. In these circumstances, I find that it is not clear on the evidence whether Mr Lisseter had obtained the approval of the full Governing Body at the time he signed the two variations to the Contract, but that the full Governing Body is likely to have become aware of the signature of the two variations subsequently, in particular when the budget came to be revised, and to have approved the decision to enter into the variations at that stage.

The failure to follow the Scheme and the principles of best value

334. I have already dealt with the status of the Scheme. I do not accept that the reference in the College's Scheme of Delegation to the Scheme was intended to or did have any effect greater than the Scheme itself did. These provisions served as an important reminder to those taking decisions on behalf of the College as to the obligations they were under when exercising their functions, but they did not define the scope of their authority.

335. I have reached the same conclusion in relation to the principles of "best value". However, the College's reliance upon this provision suffers from the further difficulty that this was not intended to be a reference to the concept of "best value" at large (an inherently vague concept), but to a specific document which was not identified, and which no one suggested was ever drawn up.

336. In relation to both of these arguments, I have been fortified in my conclusions that they do not provide the College with a defence to a claim under the Contract by the observations of the Privy Council in *Central Tenders Board v White [2015] BLR 727*, para 25 when addressing the argument that the board's failure to follow a procedural precondition of its own making had the effect that the resultant contract was void:

"For the court to invalidate a contract entered into between a public body and a party acting in good faith, by reason of a procedural defect in the contractual process, and moreover to do so without compensation (for it is not obvious what compensation would be available), would be a serious denial of that person's rights. It would offend against orthodox principles of private law (contractual rights) and public law (the right not to be deprived of property without compensation)."

The other contractual issues

337. Two further defences were advanced to the claimants' claim in contract, which I will deal with briefly.

The repudiation issue

338. First, the College contends that if it was in repudiatory breach of Contract in ceasing to pay and announcing its intention not to pay hire, only GCP could accept that repudiation, as the assignee of the right to the hire payments under the RSA, but it was SFM who purported to do so.

339. There is nothing in this point:

- (i) The notice of assignment provided by SFM to the College on 12 September 2013 and countersigned by the College stated that SFM "may not agree to amend, modify or terminate the Contract without the prior written consent of GCP" but that the College "should continue to deal with *2002 [SFM] in relation to the Contract until you receive written notice to the contrary from GCP".
- (ii) The notice thereby held SFM out to the College as being able to represent GCP for the purposes of the Contract. No written notice to the contrary was ever served with the result that SFM was entitled to terminate the Contract as against the College and did so.
- (iii) In any event, clause 4.9.7 of the RSA allowed SFM to act on GCP's behalf in terminating the Contract, which provided SFM with GCP's written consent to terminate the Contract.
- (iv) Further, the claimants have at all times proceeded on the basis that SFM's termination of the Contract was valid as between SFM and GCP with the result that if, contrary to the view I have reached, SFM's termination of the Contract was not originally binding on GCP and for that reason ineffective as against the College, GCP has since approved and ratified SFM's termination.

The penalty issue

340. The second issue is whether clause 2.6.2.2 of the Contract constitutes a penalty. By way of a reminder, this provides that upon termination of the Contract for repudiation:

“The customer will immediately pay to BOS Hire, as an agreed pre-estimate of loss suffered by BOS Hire as a consequence of the termination, an amount equal to the aggregate of all hire charges then due but unpaid together with interest due under clause 2.2.5; plus all costs incurred by BOS Hire in enforcing or seeking to enforce this Contract and in locating and recovering the equipment; plus the sum of all further hire charges which, but for termination, would have fallen due during the minimum hire period, each discounted at 3% per annum for accelerated payment; plus all other sums due under this Contract.”

341. It will be apparent that this provision gives the claimants the full value of the bargain lost, without requiring them to give credit for any benefit which the claimants might obtain as a result of recovering the Building before the expiry of the 15-year period.

342. A failure to allow for benefits of this kind is capable of rendering an agreed damages clause penal in nature. In *Campbell Discount Co Ltd v Bridge [1962] AC 600*, 625 one of the grounds given by Lord Radcliffe for finding the clause in that case penal was that “the compensation is paid immediately, and the vehicle comes back into the owner's possession with a realisable value that, in many circumstances, may exceed the one-third balance of the price which the owner has not got in”.

343. It was common ground before me that the approach which now falls to be adopted in determining whether a liquidated damages clause is unenforceable as a penalty is that set out in the joint judgment of Lord Neuberger of Abbotsbury PSC and Lord Sumption JSC in *Cavendish Square Holdings BV v Makdessi [2016] AC 1172*, para 32, namely to ask

“whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in ***2003** simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach.”

344. However, in upholding the defendants' argument that the Contract was ultra vires the College, I have found that the Building was constructed to the College's individual specification, and that the prospects of realising value from the Building in the event that the College no longer wanted it were remote. Against the background of those findings of fact, the failure to make allowance for the remote possibility of some further re-letting of the returned Building cannot be said to involve a benefit to the claimants or a detriment to the College “out of all proportion” to the claimants' legitimate interest. For the same reason, clause 2.6.2.2 cannot properly be described as penal or intended to punish. The failure to make provision for the benefits of the claimants being able to re-let the Building was not an attempt to generate a windfall for the claimants or to punish the College, but reflected the reality of the matter which was that the only commercially viable user of the Building as designed and installed was the College itself.

345. The College also suggested that the provision in clause 2.6.2.2 which required the College to indemnify BOS Hire against “all costs incurred ... in enforcing or seeking to enforce this Contract and in locating and recovering the equipment” and the right to recover interest on outstanding amounts at 4% over base were penal. However, there is nothing in this suggestion. Both provisions protect legitimate interests on the part of the claimants (of being made whole in respect of the costs of enforcing its rights following a breach, and in respect of the time value of money of debts which are outstanding, in circumstances in which the failure to pay on time involves an enhanced credit risk). Provisions of this kind are routinely found in many kinds of contracts.

The misrepresentation and misstatement claims

Introduction

346. If (as I have found) the Contract is void, the claimants bring alternative claims under [section 2\(1\) of the Misrepresentation Act 1967](#) and in the tort of negligent misstatement based on what are alleged to be statements made in the College's and Council's Letters of 13 and 14 February 2013.

347. The College's letter provided:

“I certify to you as follows:

“1. The school is a maintained school for the purpose of the [School Standards and Framework Act 1998](#) (as from time to time amended, varied or re-enacted) and has the power and capacity to enter into leases and lease assets of the type represented by the asset on the terms set out in the lease by virtue of the budget delegated to it by The Isle of Wight Council and the expenditure will fall within that budget.

“2. The Governing Body has taken all necessary corporate and other action required by applicable law or regulations to authorise the execution of and performance under the lease.

“3. In my view and that of the Governing Body, the transaction embodied in the lease is not one which will result in the school being **2004* required, in accordance with proper practice, to recognise a fixed asset in any balance sheet, the Governing Body having concluded that the lease is ‘an operating lease’ for the purposes of applicable guidance and standards. Accordingly, the school will not by entering into and performing its obligations under the lease be in breach of any restriction upon its power to incur capital expenditure or expenditure on capital financing.

“4. So far as the Governing Body is aware, all relevant provisions in the [Education Act 2002](#) and the [Schools Finance \(England\) Regulations 2012](#) (as from time to time amended, varied or re-enacted) and all other relevant legislation and regulations, together with the Isle of Wight Scheme for Financing Schools (revised April 2012) have been and are being complied with by the school;

“5. To the extent applicable, all legislative and/or regulatory requirements relating to competition have been complied with in approving the Lease; and

“6. The leasing of the Asset under the Lease will facilitate or is conducive or incidental to discharge the statutory function(s) of the school. I am sending you under cover of this certificate copies of the minutes of the Governing Body authorising the execution and delivery on behalf of the school of the lease and certificate.

“I have made all inquiries and obtained all advice necessary to enable me to issue this certificate to you. I acknowledge that if you enter into the lease you may do so in full reliance upon this certificate.”

348. The Council's Letter provided:

“1. The Council agrees that the expenditure to be incurred by the Governing Body under the hire contract and otherwise in connection with the project falls within the delegated budget and is not the responsibility of the Council under the [Schools and Standards Framework Act 1998](#) , or otherwise.

“2. The Council is satisfied that the Governing Body has complied with the requirements of the Council's Scheme for Financing Schools in relation to the procurement of the project.

“3. The Council accepts and agrees the Governing Body's assessment of the Hire Contract as an ‘operating lease’ for the purposes of applicable guidance and standards.

“4. The Council approves the entry into the hire contract by the Governing Body and agrees that the same will not cause the Governing Body to be in breach of any restrictions or obligations stated in the Scheme for Financing Schools or exceed any limitations on the powers of the Governing Body stated in the [Schools and Standards Framework Act 1998](#) .”

“The Council ... have no objection to the Governing Body providing a copy of the letter to BOSHire Ltd.”

349. The claimants’ claim that, if the defendants’ “no capacity” defence succeeds, these statements were untrue, that they entered into the Contract in reliance upon them, and suffered loss as a result.

350. The claimants’ pleaded reliance case is as follows: **2005*

“But for the negligent representations which were made by the College and/or Council ... BOSHire would not have entered into the hire contract with the Council and/or College and would have sought to hire the equipment out to an entity with legal capacity.”

351. The case, therefore, was not that, but for the alleged misrepresentations and misstatements, BOSHire would not itself have acquired the Building from BOS (avoiding whatever expenditure it incurred by doing so), nor that that it would not have taken out financing. The case is that loss would have been avoided because BOSHire would have entered into an equivalent contract with a counterparty who did have capacity.

352. When the claim was amended to join BOSHire and GCP as parties, a further act of reliance was pleaded, namely they would not have accepted the assignment but for the misrepresentation. However, no reliance case was formulated on the basis of the loss suffered by SFM or GCP in entering into the assignment. The bare act of entering into the assignment (which involves a transfer of rights, but, of course, not obligations), would not appear to involve any detriment to SFM.

353. The nature of the claimants’ reliance case, as explained in the claimants’ supplemental opening argument, was that, absent the alleged misrepresentations and misstatements, the position the claimants would have been in “is one of having had a valid Hire Contract for, at least, its minimum term. This is the sum of £6,678,410”.

354. By the time the case closed, the claimants put the case as follows:

“The claimants would have entered into an agreement for, substantially if not the exact, same value, as the agreement in question. Asking the court to find that a commercial party whose very business is in the design, manufacture and funding of relocatable modular hire, that it would simply have done nothing at all, flies in the face of commercial common sense and reality. Obviously, BOSHire was ‘in the market’ to do a deal, in joint venture with built offsite, to the tune of the value of the agreement.

“The claimants plainly suffer an evidential disadvantage in demonstrating that they would have entered into the agreement with a party with capacity, because it did engage, for a lengthy period of time, with the College and so no evidence can really be adduced that a third party was waiting in the wings, as business resources were directed towards the agreement. Obviously, if that had not been the case and the College and Council had not been prepared to provide the relevant assurances then BOSHire would have directed those resources to the hypothetical third party. This ought not to pose a difficulty for the court. The notion of a ‘fair wind’ is now well-established in the case law. The basic justification for the fair wind principle is that, because it is the defendants’ fault that the claimants have lost the opportunity of entering into the agreement, the burden falls to them to demonstrate that no loss is really caused thereby. This works to give the claimants a fair wind in terms of the value of what they have lost. It is submitted that, in this case, that fair wind should operate such as to encompass the lost hire charges that would have been recovered over the minimum hire period from the defendants. That is what would have been recovered had the **2006* claimants not relied upon the defendants’ misrepresentations, albeit that the specific quantum looks like an expectation measure ...”

Are the misrepresentation and misstatement claims barred by the ultra vires finding?

355. Clearly, if creatures of statute (be they public or private bodies) could make legally enforceable promises that they had the capacity they lacked, there would be little room for the ultra vires doctrine to operate. The same would be true if the public body could be held, by a doctrine of estoppel, to a representation it had made that it had the capacity it lacked.

356. When an attempt was made to advance an estoppel argument in response to a local authority's lack of capacity in *Rhyl Amusements [1959] 1 WLR 465*, 473 Harman J observed:

“It would destroy the necessity of ever obtaining consent if a statutory body omitting to obtain it could thereafter be held estopped. Such a body could by these means confer on itself a power which it had not got, and the ultra vires doctrine would be reduced to a nullity.”

357. The rationale of that rule, as summarised in a passage from *Halsbury's Laws of England* which was cited with approval by the Court of Appeal in *Janred Properties Ltd v Ente Nazionale Italiano per il Turismo (unreported) 14 July 1983*, is that “a party cannot by representation, any more than by other means, raise against himself an estoppel so as to create a state of things which he is legally disabled from creating” (vol 16, para 1596).

358. A similar rule must apply where the claimant seeks to enforce a promise that a transaction is intra vires, so as to require the defendant to put it in the same position as if the transaction had been intra vires. Once again, such a promise, if enforceable, would create the very state of things which the promisor is legally disabled from creating. For this reason, Rix LJ in *Eastbourne Borough Council v Foster [2002] ICR 234*, para 32, when referring to an agreement which the Council had purported to enter into which it was agreed was ultra vires, observed that “no reliance can be placed on any promise or representation that merely reflects an alternative legal foundation for binding the council to an undertaking it had no power to give”.

359. Is the rule confined to cases where the claimant seeks to place itself in the same position as if the defendant had had vires (ie when a claimant seeks to vindicate a performance interest eg by claiming an expectation measure of damages?) In *South Tyneside Metropolitan Borough Council v Svenska International plc [1995] 1 All ER 545*, 565 Clarke J had to consider a claim in unjust enrichment to recover sums paid under an interest rate swap which was ultra vires the claimant council. The bank defended those claims on the basis that it had changed its position, claiming the cost of closing out hedging transactions which had been entered into at or about the same time as the swap to manage the bank's exposure. At p 565, Clarke J rejected the bank's contention that it could rely upon a representation or assumption that the transaction was valid:

“Mr Mann submits that in so far as he relies upon the representation or assumption the only defence available to him would be one of estoppel. However he submits that both in principle and on the *2007 authorities a plea of estoppel would fail. The reason is that the representation or promise that the transaction was valid and any assumption to the same effect would be void. Since ... the transaction is ultra vires and void, it follows that any promise, representation or assumption to the contrary is also void. I accept that submission. It appears to me that in principle the one follows from the other. The submission is also in my judgment supported by the authorities ...”

“In my judgment in circumstances such as these the bank is not entitled to rely upon the underlying validity of the transaction either in support of a plea of estoppel or in support of a defence of change of position. That is because the transaction is ultra vires and void. It is for that reason that in a case of this kind, save perhaps in exceptional circumstances, the defence of change of position is in principle confined to changes which take place after receipt of the money. Otherwise the bank would in effect be relying upon the supposed validity of a void transaction.”

360. *Svenska*, therefore, is a case in which it was held that the bank could not advance a change of position defence on the basis that it had entered into a further transaction in reliance on a representation made by a public body that the initial transaction was valid, because the representation was also void.

361. In *Salmon Harvester Properties Ltd v Metropolitan Police Authority [2004] EWHC 1159 (QB)*, Owen J heard a strike-out application in a case in which the claimant brought a claim for damages for a misrepresentation and negligent misstatement that the defendant “had or would obtain, power to enter” an agreement with the defendant to redevelop Bow Street police station which the defendant was later advised was ultra vires. The defendant sought to strike out the claim on the basis that any misrepresentation or misstatement as to its ability to enter into the transaction was also caught by the ultra vires rule and

therefore void. In response, the claimant submitted that it was not seeking to claim “the loss of profit that the claimant would have made had the relevant representations been true and the agreement been valid and enforceable (expectation loss)” but “expenditure wasted as a consequence of the representations being made (reliance loss)” (para 11). Owen J refused to strike out the claim on the basis that it was “clearly arguable” that *Svenska* and *Rhyl Amusements [1959] 1 WLR 465* could be distinguished in the manner suggested because “[the] critical point is that the claim is not based upon a representation or assumption that the transaction in question was a valid and enforceable contract” (para 12).

362. The arguments in *Salmon Harvester* disclose two possible grounds of distinction between the facts of that case and the decision in *Svenska*. The first is between expectation loss and reliance loss. However, as I have indicated, the decision in *Svenska*, although not concerned with a claim to recover loss, did involve a failed attempt to assert a reliance interest. If an attempt to rely on an additional transaction concluded in reliance on a representation by a public body as to the validity of the first fell foul of the ultra vires doctrine, I find it difficult to see why reliance constituted by the failure to enter into an alternative transaction with a third party in reliance on such a representation should be any different. Indeed the argument that, if a claimant had not been led to believe it could contract and had contracted with the public body, *2008 it would have done the same or similar deal with someone else might be thought to come even closer to an attempt to visit on the public body the very responsibilities it did not have legal capacity to undertake than the argument advanced before, but rejected by, Clarke J.

363. The second potential ground of distinction is between a representation that the transaction was valid, and a representation that the public body had or would obtain power to enter into a transaction. On its own, this distinction cannot be decisive: it might be said to be implicit in any representation by a public body that it was entering into a valid transaction that it had power to enter into that transaction. However, the facts of *Salmon Harvester* involved a case in which the transaction which would have been ultra vires was never entered into, but the claimant was led some way down the garden path on the basis that it could and would be concluded, incurring expenditure along the way. I can well understand why Owen J thought that was a factual scenario in which the application of the principle in *Rhyl Amusements* and *Svenska* merited consideration after the facts had been found at a trial.

364. In the present case, I do not believe that it is possible to distinguish *Rhyl Amusements* and *Svenska* so far as the statement-based claims against the College are concerned. The substance of the claimants’ case is that it was led to believe that it could and had entered into a valid contract with the College. The fact that the representation in question was based on a letter provided by the College at or around the same time as the College signed the Contract cannot provide a meaningful distinction from those cases where the representation is as to the validity of the contract itself, and I do not think that the decisions in *Rhyl Amusements* and *Svenska* can be circumvented by this simple drafting device. Further, the form of reliance loss which the claimants seek, and which is the only claim advanced under the misrepresentation and misstatement heads, is one which protects their expectation interest, and which visits the cost of fulfilling those expectations on a public body which lacked capacity to create and fulfil those expectations in a legally relevant sense.

365. However, the statement-based claims against *the Council*, in relation to a transaction to be entered into (as I have found) by the College, does not give rise to this difficulty. While there are likely to be circumstances in which enforcing a claim against one public body on the basis of a representation or promise by it that a transaction to be concluded by a different public body was intra vires might fall foul of the ultra vires doctrine (eg two public bodies, each lacking the capacity to transact and each promising or representing that the other had it), in this case the Council did not seek to establish that it would have been outside its own capacity to enter into a transaction of this type. There was no attempt to argue that it would have been ultra vires for the Council itself to enter into the Contract by reference to the statutory provisions applicable to it, nor to establish that the Council's decision to sign the 14 February 2013 letter was unlawful as a matter of public law.

366. For these reasons, my finding that the Contract was ultra vires the College precludes the statement-based claim advanced against the College by reference to the terms of the College's Letter, but does not preclude a statement-based claim against the Council by reference to the terms of the Council's Letter. *2009

The claim under the Misrepresentation Act 1967

367. I can deal with this claim briefly because there are two threshold difficulties with it.

368. First, the claimants advance this claim on the premise that the Contract is void. However, if there is no contract, there can be no claim under the *Misrepresentation Act 1967*. I shall not labour the point by extensive reference to the Act, but its provisions make it absolutely clear that it only applies between parties to a contract which is entered into after one contracting

party has made a misrepresentation to the other. None of these preconditions to its application can be satisfied if, as I have found and as this part of the claimants' case assumes, no contract was ever concluded. This is also fatal to a [section 2\(1\)](#) claim against the College.

369. Second, I have found that the Council was not the actual (or putative) contracting party, which is itself fatal to a claim under the 1967 Act against the Council: *Atlantic Lines and Navigation Co Inc v Hallam Ltd (The Lucy)* [1983] 1 Lloyd's Rep 188 .

The claimants' case on loss

370. I am going to take the remaining elements of the misrepresentation and misstatement claims out of their logical order, because I have concluded that the claims face insuperable evidential difficulties in relation to the sole basis on which it is asserted that loss was suffered, with the result that I will be able to deal more briefly with the "upstream" issues of what duties were owed, what representations were made, whether any duties were breached and whether there was reliance.

371. The claimants have adduced no evidence capable of supporting the claim that it would, but for the alleged misrepresentation by the Council, have entered into an alternative transaction on the same or substantially the same terms with a third party. Neither Mr Pierce nor Mr Spring gave any evidence to this effect. The only evidence given by Mr Spring was that if the Council had not provided its letter, BOSHire would not have entered into the Contract.

372. The suggestion that, but for this transaction, BOSHire would have entered into a contract with a third party on essentially similar terms, is inherently unlikely:

- (i) As I have set out above, I am satisfied that to a significant extent, the Building was constructed to the bespoke requirements of the College. The suggestion that another entity would have leased the same structure on the same terms is implausible.
- (ii) On the evidence, the Contract represented an unprecedented and unusual transaction for BOSHire. Mr Spring stated that "the value of the project was significantly greater than the projects we usually engaged in", BOSHire's previous experience being of transactions which "ranged from £250,000 to £1.5m". The claimants have not begun to establish the likely existence of an available alternative transaction of a similar kind.
- (iii) Further, the reliance case presupposes not simply the existence of another opportunity of this unprecedented size, with a counterparty able to enter into a Contract on the same economic terms without facing the same capacity issue, but also that, had such an opportunity existed, it was one which the entry into the Contract foreclosed. However, I heard no evidence ***2010** to substantiate that, had any such opportunity existed, BOS and BOSHire would not have been able to enter into it in any event (cf the position in contract damages in *WL Thompson Ltd v Robinson (Gunmakers) Ltd* [1955] Ch 177).

373. Against this background, it would take considerably more than a "fair wind" to lift the claimants' quantum case on its misrepresentation and negligent misstatement claims off the ground. I find that the claimants have failed to establish this essential element of their statement-based claims.

The factual background to the College's and Council's Letters

374. There can be no doubt that BOSHire knew considerably more about the vires risk than the College. Mr Spring accepted that he was "well versed in the ultra vires issue". This is scarcely surprising, given that a central aspect of BOSHire's business was making contracts with "local authorities and with quasi organisations like schools and colleges". In its early dealings with the College, it must have been apparent to BOSHire that the College had, at best, a rudimentary understanding of this issue, not least from the fact that the College used terminology and made requests which would not be appropriate on the intended accounting treatment (viz the requests for an option to purchase). BOS's salesman, Mr Blow, appears to have shared some of the same misapprehensions. However, BOSHire was clearly keen that the College acquire a better understanding of the issues, and the informational imbalance was redressed to some extent when the College received legal advice from Mr McGruer of Blake Laphorn (although I note that unlike BOSHire's adviser Ms Yardley of Watson Farley & Williams llp, Mr McGruer appears to be primarily a planning rather than an asset finance specialist).

375. However this was not a case in which BOSHire looked to the College for advice or guidance on the law, or for information as to what the legal constraints on the College's power to contract were. Mr Spring was aware of the prohibition on borrowing under [paragraph 3\(4\) of Schedule 1 to the Education Act 2002](#) , and of the terms of the Scheme. He was fully aware of the

accounting issues which arose in relation to the classification of leases into operational and finance leases. And so far as the key inputs into that accounting assessment were concerned—the terms of the Contract (which Mr Spring drafted with an eye to the distinction between operating and finance leases), the value of the Building, the extent to which it had been specially modified for the Council's requirements, its economic life and the extent of any likely residual value of the Building after 15 years—BOSHire was considerably better placed than the College to form a view on these issues, and I find that it did so relying on its own knowledge, experience and the legal advice it received.

376. It is significant that BOSHire never asked the College to explain what, if any, calculations it had done in satisfying itself that the Contract was not a finance lease, nor did the College ever ask BOSHire for the inputs necessary to perform such a calculation. It must have been obvious to BOSHire that the College had not undertaken any assessment of this kind before issuing the College's Letter.

377. It was BOSHire which set the economic parameters of this transaction, which were barely negotiated by the College, and BOSHire knew that the status of the Contract as an operating or finance lease would to **2011* a significant extent depend on those economic parameters. Mr Spring was commendably frank on this issue when giving evidence:

Q . Yes, and of course it's open to you to be very cautious and to make sure you don't get anywhere near whatever you think the PVLMP bright line is; correct?

A . Correct, yes. But of course, the more cautious I am, the less financial reward there is. It's a typical customer/supplier quandary or conflict, which is where—you know, my duty to my shareholders is to get the best price and the customer is always looking at the best price for them.

Q . So it's a commercial decision?

A . Yes.”

378. I accept that BOSHire was keen to ascertain that the College took the same view of the classification of the lease that it took albeit, as I have stated, it must have been obvious to BOSHire that the College's view was not an informed one resulting from any close analysis of the issues. Had the College entered into the Contract, and then immediately classified the lease as a finance lease, the consequences for the Contract and BOSHire were obvious. Obtaining the College's Letter provided some comfort on this score, as well as providing BOSHire with evidence that the College was intending to adopt this classification which BOSHire could deploy when seeking to raise funding. Finally, the College's Letter may have been seen as providing BOSHire with some protection against any argument that the College had relied on BOSHire's advice in entering into the transaction.

379. Ultimately, however, BOSHire knew that the ultra vires risk existed whatever the College said, and that the playing out of that risk would turn upon the application of the relevant legislation and accounting standards in the light of the economic parameters of the transaction. BOSHire did not rely upon the College's assessment in respect of any of those three matters, on each of which it rightly regarded itself as better placed to make an informed assessment.

380. The position in relation to the Council's Letter is even more stark. It is clear on the evidence that the terms of the Council's Letter were prepared by Mr Spring of BOSHire, with input from Ms Yardley of Watson, Farley & Williams llp. While BOSHire had originally hoped for a more comprehensive and direct assurance from the Council (including a statement that the Council, its legal advisers and auditors agreed with operating lease classification under IAS 17), discussions between Mr Spring and the College and its adviser Mr McGruer culminated in the recognition that this was unlikely to be forthcoming. BOSHire was aware that the more it sought by way of reassurance from the Council, the greater the risk that not only would that request meet with refusal, but that the Council might seek to discourage the College from going ahead. It was decided that the Council was likely to respond more favourably if the request to sign a letter came from the College rather than BOSHire.

381. On 14 February 2013 Ms Goodhead provided the Council with the draft letter from the College to the Council, saying that the College had been asked to provide “certain formal assurances regarding the Governing Body's powers” to enter into the Contract and that the College had in turn sought “assurances” from the Council as to the College's powers “in order **2012* to complete the College's records and as support for the assurances to be provided by the Governing Body”. That language was criticised by the Council, on the basis that it did not fairly reflect the process by which the request had come to be formulated and put forward nor the reasons why the Council was being asked to provide the Letter. However, the purpose of the Council's

Letter, and the fact that it was being sought to provide reassurance to BOSHire, was clear from its terms, and I do not think the Council can have been in any real doubt as to who wanted the Council's Letter and why.

382. The Council drafted and returned a response which expressed its “agreement” with the “assurances which have been given to the Governing Body”. The letter was produced and returned on the same day as the request was made. BOSHire received the signed letter the next morning, which Mr Spring recognised at the time was “really quick”. Mr Spring accepted in evidence that he had no idea whether the Council had undertaken any detailed consideration or obtained any advice on the contents of the Council's Letter. Given the turn-around time, it should have been obvious that it had not. The dilution of the reassurance BOSHire decided to seek from the Council, and the removal of any references to the directors of finance and legal services and the Council's auditors, reflected a recognition that the Council would be reluctant to provide reassurance on this basis, and a hope that, in its diluted form, the letter would not receive significant scrutiny within the Council. It would be wholly inappropriate in these circumstances to give BOSHire, through an implied representation, the higher level of reassurance which BOSHire had decided not to seek in express terms. The Council's Letter would have given BOSHire reassurance that the Council was unlikely to put a spoke in its wheels, and it gave it a document to show potential funders which evidenced a benevolent attitude on the Council's part to the project, but no more.

383. Mr Spring accepted that the Council's Letter gave BOSHire reassurance that the Council took “the same view as the College”—and, he might have added, as BOSHire—“about the status of the hire contract as an operating lease”. However, once again I reject any suggestion that BOSHire relied on the Council's Letter for the purpose of forming its own view as to the College's power to enter into the Contract. As I have said, it relied upon its own knowledge, expertise and the advice it received.

What representations were made?

384. Against this background, I turn to consider the issue of what representations were made in the College's and Council's Letters. In determining what representations, if any, are made by a document, context is key. In *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] CLC 518, 531 Mance J stated:

“The meaning and effect of words never falls to be viewed in a vacuum. It is shaped by the context of their communication, including the parties’ respective positions, knowledge and experience. A description or commendation which may obviously be irrelevant or may even serve as a warning to one recipient, because of its generality, superficiality or laudatory nature, or because of the recipient's own knowledge and experience, may constitute a material representation if made to another less informed or sophisticated receiver. Even in the *2013 case of a written description, there may be cases where a proposal or presentation misrepresents the nature or working of a transaction to a particular reader, although another sophisticated, more analytical or legally qualified reader would have been expected to appreciate the real nature or working of the transaction. What is fair and adequate presentation in one context between one set of negotiating parties may be unfair or inadequate in another context. Whether there was any and if so what particular representation must thus depend upon an objective assessment of the likely effect of the proposal or presentation on the recipient. In making such an assessment, it is necessary to consider the recipient's characteristics and knowledge as they appeared, or ought to have appeared, to the maker of the proposal or presentation. A recipient holding himself out as able to understand and evaluate complicated proposals would be expected to be able to do so, whatever his actual abilities. These are problems on which it is commonly not necessary to focus in a commercial context. The assumption on which most business is conducted is that both parties understand, or avail themselves of advice about, the area in which they are operating and the documentation which they use. Business could not otherwise be carried on.”

385. On the basis of the findings I have made, I am satisfied that the College's and Council's Letters involved nothing more than representations of the College's and Council's opinions on the issues addressed at that point, but involved no representation as to whether there were reasonable grounds for those opinions. The issues addressed in the Letters were essentially matters of professional judgment, and BOSHire knew that it was significantly better placed than the College and the Council to make that judgment. Given that imbalance in knowledge and expertise on the key issues, and the fact, as I have found, that it must have been obvious to BOSHire that neither the College or the Council had undertaken any significant independent investigation of the operating lease/finance lease dichotomy, it would not be appropriate to imply a further representation that the College or Council had reasonable grounds for their views. As Mance J noted in the *Banker's Trust* case at p 531, such an implication will ordinarily only be appropriate where it is reasonable for “the representee to rely on the representor's statements rather than on his own judgment”. Such an implication would be fundamentally inconsistent with the realities of the parties’ exchanges,

which did not involve BOSHire seeking to ascertain the view of more knowledgeable parties so that it could rely upon those views, but BOSHire seeking the reassurance from obviously less knowledgeable parties that they were both on the “same page” in relation to the view BOSHire had independently formed.

386. That limited reassurance was given, but it did not prevent the College or Council from revising its views in the future on further consideration. It would take a promise or an estoppel to achieve that effect, but neither offers a viable legal argument to the claimants in this case.

Were such representations as were made untrue?

387. The claimants do not suggest that the College and the Council did not, at the date they issued their respective letters, honestly hold the views set *2014 out in those letters. Accordingly, the only representations which were made were true.

388. If I am wrong in my conclusion that the College and/or the Council did not make any implied representation that they had reasonable grounds for the opinions they stated they held, then such further representations would have been untrue in each case. There was no evidence of either the College or the Council undertaking any consideration of the Contract by reference to IAS 17 for the purpose of applying the operating lease/finance lease classification, still less of seeking to obtain the input data necessary to perform such an assessment with reasonable skill and care.

Did the College and/or the Council owe BOSHire a duty of care in making such representations as they made?

389. Had the [Misrepresentation Act 1967](#) applied, there would have been no need for the claimants to establish a duty of care in relation to representations made to it by its contractual counterparty which led BOSHire to enter into the Contract. However, a claim under the 1967 Act is not available for the reasons I have set out.

390. The claimants advance an alternative claim based on a *Hedley Byrne* duty of care (*Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465*). I accept that the College and the Council were obliged accurately to set out their honest opinions on the status of the Contract in their respective letters, and I have found that they did so. However, I reject the suggestion that they owed the claimants any wider duty to take care, and I also reject any suggestion that either the College or the Council owed any form of advisory duty to BOSHire in relation to the contents of their respective letters.

391. I was referred on this issue to the following statement of the relevant legal principles by Lord Oliver of Aylmerton in *Caparo Industries plc v Dickman [1990] 2 AC 605* , 638:

“What can be deduced from the *Hedley Byrne* case, therefore, is that the necessary relationship between the maker of a statement or giver of advice (‘the adviser’) and the recipient who acts in reliance upon it (‘the advisee’) may typically be held to exist where (1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given; (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose; (3) it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent inquiry, and (4) it is so acted upon by the advisee to his detriment.”

392. I was also referred to the statement by Lord Wilson JSC in *NRAM Ltd (formerly NRAM plc) v Steel [2018] 1 WLR 1190* , para 19:

“If it is not reasonable for a representee to have relied *2015 on a representation and for the representor to have foreseen that he would do so, it is difficult to imagine that the latter will have assumed responsibility for it. If it is not reasonable for a representee to have relied on a representation, it may often follow that it is not reasonable for the representor to have foreseen that he would do so. But the two inquiries remain distinct.”

393. In his judgment, Lord Wilson JSC referred with approval to the observations of Neill LJ in *James McNaughton Paper Group Ltd v Hicks Anderson & Co* [1991] 2 QB 113 , 126–127:

“One should therefore consider whether and to what extent the advisee was entitled to rely on the statement to take the action that he did take. It is also necessary to consider whether he did in fact rely on the statement, whether he did use or should have used his own judgment and whether he did seek or should have sought independent advice. In business transactions conducted at arms’ length it may sometimes be difficult for an advisee to prove that he was entitled to act on a statement without taking any independent advice or to prove that the adviser knew, actually or inferentially, that he would act without taking such advice.”

394. As these authorities make clear, the negligent misstatement duty is aimed at statements made by an adviser with special skill, undertaking a responsibility to advise another, who will reasonably rely upon that advice without independent inquiry. For the reasons already stated, that is not this case. BOSHire was not looking to the College or Council, neither of whom could be said to have any specialist expertise on the material issues, for advice. There can be no question of either the College or Council knowing the BOSHire would rely on the contents of their respective letters without independent inquiry, nor of it being reasonable for BOSHire to do so. As the College's counterparty in the intended arm's-length transaction, it was for BOSHire to form its own views and to take its own advice on these issues, and it did so.

395. If the Council had owed a duty of care in relation to the statements made in the Council's Letter, I would have rejected the Council's submission that this duty did not extend to BOSHire, because they were not an addressee of the Council's Letter. In *Playboy Club London Ltd v Banca Nazionale del Lavoro SpA* [2018] 1 WLR 4041 , para 11 Lord Sumption JSC addressed the position in which those making statements might owe a duty of care as to their contents to persons other than the immediate recipient in the following terms:

“Mr Salzedo QC, who appeared for the Playboy Club, accepted that there was no evidence that BNL knew that its reference would be communicated to or relied on by anyone other than Burlington. He also accepted that in the ordinary course where a statement is relied upon by B to whom A has passed it on, the representor owes no duty to B unless he knew that the statement was likely to be communicated to B. That concession was plainly justified. I would go further and say that the representor must not only know that the statement is likely to be communicated to and relied upon by B. It must also be part of the statement's known purpose that it should be communicated and relied upon by B, if the representor is to be taken to assume responsibility to B.” *2016

396. In the present case, the College had sought assurances from the Council on matters of obvious potential significance in relation to a proposed transaction between the College and BOSHire, the content of those assurances being directly concerned with BOSHire's rights under that transaction, and permission was sought and given to show the Council's Letter to BOSHire. This was a case, therefore, in which the Council not only knew that the Council's Letter was being shown to BOSHire, but knew that one of the purposes of seeking the Council's Letter was in order that it could be so shown. In these circumstances, it was part of the Council's known purpose in issuing the Council's Letter that it be provided to and relied upon (for whatever it was worth) by BOSHire.

397. Finally, if the College and/or the Council had owed BOSHire a duty to provide advice to them in relation to the matters stated in their respective Letters, and to do so with reasonable skill and care, both the College and the Council would have been in breach of that duty, essentially for the same reasons as I have concluded that any representation by the College or the Council that they had reasonable grounds for the opinions set out in their respective letters would have been untrue.

Did BOSHire rely on such misrepresentations or misstatements as may have been made?

398. I have already found that BOSHire did not rely on the statements in the College's and Council's Letters in the sense that the making of the statements caused or influenced BOSHire's belief as to the correctness of the matters they asserted. BOSHire formed its own view, and (rightly) proceeded on the basis that it knew a good deal more about the issues canvassed in the Letters than either the College or the Council.

399. However, I accept Mr Spring's evidence that BOSHire would not have gone ahead with the transaction if the College and the Council had refused to provide the Letters. Mr Spring had certain minimum documentary requirements for the transaction, influenced to a significant degree by the documents he thought he would need to raise funding, and the Letters formed part of those minimum requirements.

400. However, in my view that is not sufficient to constitute reliance for the purposes of claims in misrepresentation or misstatement if the statements in the Letters proved to be untrue. It has been held that someone with strong suspicions that a statement is untrue may nonetheless rely on that statement for the purposes of the tort of deceit and as a basis for obtaining rescission of a contract (*Zurich Insurance Co plc v Hayward* [2017] AC 142). Giving the main judgment, Lord Clarke of Stone-cum-Ebony JSC held that “it is not necessary, as a matter of law, to prove that the representee believed that the representation was true” to establish the tort of deceit (para 18). In that case, the tort of deceit was made out when an insurer entered into a compromise agreement because of a risk that a third party (the court) would accept as true a statement made to the insurer and which would be repeated to the court which the insurer strongly suspected was false. In *Holyoake v Candy* [2017] EWHC 3397 (Ch) at [391]–[392] Nugee J identified two important features of the *Zurich* decision: (a) that the insurers did not know that the claim was false and (b) that the insured's lies might influence the court that would fix the value of the claim (at paras 391–392). He concluded, at para 393: **2017*

“[It] was a case where A lies to B and B is induced to act in a particular way because of the risk that A might tell the same lie to C and the effect that that might have on C. It is difficult to see that that principle can have any application where there is no third party or C involved. Where all that happens, as in the present case, is that A tells a lie to B, it is difficult to envisage the circumstances in which that can induce B to act in a particular way unless B is taken in and believes that what A says is true, or at least might be true.”

401. The decision in *Zurich* has not been without its critics (see for example Paul S Davies and William Day, “A Mistaken Turn in the Law of Misrepresentation” [2019] LMCLQ 390). However, it is a case in which the significance of the misrepresentation lay in the fact that the making of the misrepresentation might cause someone (in that case, a court) to believe that the matters asserted were true. Where the only significance of a representor's assertion of the truth of a state of affairs is the fact that it is made, not that the making of the statement would cause someone to accept the truth of the matters represented, that is not, in my view, capable of supporting a cause of action in misrepresentation or misstatement. It would involve a fundamental, and to my mind unjustified, expansion of the traditional scope of representation-based torts if a contracting party could protect itself against a known risk of an intended transaction by requiring someone to make a representation as to the absence of that risk as a condition of proceeding, in circumstances in which the statement did not cause or influence the contracting party's evaluation of the risk. A party who wishes to allocate a risk of contracting of this kind must do so by contract, or not at all. When, as in the present context, it is not possible to allocate the risk to the contractual counterparty by a binding promise because the counterparty lacks the capacity to give such a promise, it would be particularly surprising if the risk of lack of capacity could nonetheless be transferred to that party by requiring it to make a statement on the truth of which the claimant did not rely.

The position as between the first to third claimants

402. Given the findings I have made, which involve the misrepresentation and misstatement claims failing at a number of levels, it is not necessary for me to expand an already long judgment by addressing the issue of which of the three claimants had the right to claim in misrepresentation and misstatement and for what loss. I would only observe that if a viable claim for substantial damages had survived this far in its analytical journey, it is unlikely it would have fallen down a black hole at the finishing line (see *Offer-Hoar v Larkstore Ltd (Technotrade Ltd, Part 20 defendant)* [2006] 1 WLR 2926). Nor is it necessary to consider the arguments on whether BOSHire failed to mitigate any loss which it may have incurred, or whether any damages it can recover fall to be reduced by reason of contributory negligence.

The claimants' claim in unjust enrichment

403. If, as I have held, the Contract is void because it fell outside the College's capacity to contract, and there is no remedy in misrepresentation **2018* or negligent misstatement, the claimants bring a claim in unjust enrichment against the College, on the basis that the College has been unjustly enriched at the claimants' expense through the retention and use of the Building.

404. The unjust enrichment claim is advanced by each of BOS Hire, SFM and GCP. No defence of change of position is advanced, but the College does say that (a) only GCP is entitled to claim; and (b) that BOS Hire and/or SFM and/or GCP acted at their own risk, and for that reason are not entitled to make any recovery.

Who is the correct claimant?

405. The proper claimant in an unjust enrichment claim is the party at whose expense the other party has been unjustly enriched. In this case there are three candidates: BOS Hire, SFM and GCP.

406. Lord Reed JSC in *Investment Trust Companies v Revenue and Customs Comrs [2018] AC 275*, para 37 observed that: “Decisions concerning the question of whether an enrichment was ‘at the expense of’ the claimant demonstrate uncertainty as to the approach which should be adopted”. He noted at para 42 that unjust enrichment was “designed to correct normatively defective transfers of value, usually by restoring the parties to their pre-transfer positions”. Lord Reed JSC observed that “the expression ‘transfer of value’ is ... too general to serve as a legal test”, but that unjust enrichment presupposes that the defendant has received a benefit from the claimant, with the claimant having suffered a loss through the provision of the benefit (para 43). The editors of *Goff and Jones, The Law of Unjust Enrichment*, 9th ed (2016), para 6.03 also use the concept of “transfer of value” to identify at whose expense a particular benefit has been conferred, as does Professor Burrows QC in *The Law of Restitution*, 3rd ed (2010), pp 66–67. In a case of so-called “direct providers” of benefit (in contrast to the third-party case where a benefit which should have gone from A to B goes from A to C), the enrichment enjoyed by the recipient will generally come at the expense of the person who directly transferred that value to the recipient.

407. In this case, there was a direct transfer of value by the owner of the Building, who had the right to reclaim possession of it, to the College, who enjoyed that possession. The original owner of the Building was BOS Hire—the terms of the Contract record that BOS Hire was acquiring the Building from BOS for the purposes of the Contract. However, the notice of assignment of 5 June 2013 provided that “SFM will be or become the legal owner of the equipment in due course”. While I have not seen the document by which this transfer was effected, this had clearly happened by 4 July 2013, when SFM entered into the RSA with GCP, clause 3.1.6 of which warranted that SFM was the legal and beneficial owner of the Building. Accordingly I am satisfied that by the time the College took possession of and began to use the Building in September 2013, SFM was the owner.

408. In the period after September 2013, the transfer of value to the College in the form of possession and use of the Building has involved loss to SFM as the owner, because SFM as owner would otherwise have enjoyed those rights, and would have been able either to use the Building itself or sell or lease the Building to someone else. By contrast, GCP has transferred nothing to the College, and the College's enjoyment of the Building has not been occasioned by any loss to GCP. Even if the College's failure to pay for such enjoyment since September 2017 might in some sense be treated as a **2019* loss to GCP, it is not a loss occasioned by the transfer of the benefit of the Building to the College, but by the College's failure to pay for the benefit so transferred.

409. I do not believe that the identification of the party at whose expense the enrichment occurred changes simply because SFM (proceeding on the erroneous basis that the Contract was valid) assigned its rights to payment under the Contract to GCP. While the College submits that “only GCP can have any claim in restitution for the College's use of the building since September 2017, because only GCP has had any right to receive hire payments in that period”, this analysis takes no account of the fact that (i) GCP has itself transferred no value to the College; (ii) the assignment by SFM of rights arising from its transfer of value is not a matter between it and the College as the enriched party but something SFM did for its own purposes; and (iii) as the Contract is void, there was never any contractual right to hire payments capable of being assigned to GCP.

410. There is, however, a separate and subsequent question of whether SFM has assigned its claim in unjust enrichment to GCP. When such an assignment takes place, Lord Reed JSC suggested in *Investment Trust Companies v Revenue and Customs Comrs [2018] AC 275*, para 48 that “the claimant stands in the shoes of the assignor, and *is therefore treated as if* it had been a party to the relevant transaction, and the defendant's enrichment had been directly at his expense”.

411. By clause 2.1 of the RSA, SFM assigned “all of the vendor's right, title and interest in and to the receivables [ie hire due under the Contract]”. In my view, those words do not encompass SFM's claim in unjust enrichment against the College. They merely assign the contractual right to payment which all parties believed had arisen.

412. In summary:

- (i) The enrichment which the College enjoyed and is continuing to enjoy through the use of the Building was and is at the expense of SFM as the owner of the Building throughout the period of possession and use by the College.
- (ii) SFM has not assigned any claim in unjust enrichment to GCP.
- (iii) The proper claimant is, therefore, SFM.

Does the claim in unjust enrichment fail because SFM knowingly took the risk that the Contract was ultra vires?

413. The College alleges that any claim in unjust enrichment is precluded because SFM was aware of the ultra vires risk when the Building was provided to the College.

414. The suggestion that claim in unjust enrichment might fail for this reason appears to have been first articulated in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, one of the cases concerned with local authorities who had purported to enter into ultra vires swaps transactions. Lord Hoffmann noted, at p 401:

“There may be cases in which banks which have entered into certain kinds of transactions prefer not to raise the question of whether they involve any legal risk. They may hope that if nothing is said, their counter-parties will honour their obligations and all will be well, whereas any suggestion of a legal risk attaching to the instruments they hold might affect their credit ratings. There is room for a spectrum of *2020 states of mind between genuine belief in validity, founding a claim based on mistake, and a clear acceptance of the risk that they are not.”

415. It will be noted that Lord Hoffmann appears to have had in mind a position where a bank becomes aware of a legal risk to a swap transaction which it had already entered into, but prefers to carry on paying out for fear that raising the issue might have adverse consequences (either from the notional counterparty or in evaluations of the bank's assets). In the same case, Lord Hope of Craighead, at p 410, addressed the position of a payer who is aware that there is doubt as to whether a particular payment is due, but who pays “without waiting to resolve that doubt”, stating “a person who pays when in doubt takes the risk that he may be wrong”.

416. Both judges returned to the issue when considering payments of tax demanded and made on the basis of a mistaken understanding of the law in *Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs* [2007] 1 AC 558. Lord Hoffmann at para 26 said that “the real point is whether the person who made the payment took the risk that he might be wrong. If he did, then he cannot recover the money”. He noted the finding at first instance that the person who had authorised the payments in that case—a Mr Thomason—had personally been in no doubt that the payments were due, and observed that this was sufficient to establish a mistake. As is clear from the judgment of Lord Brown of Eaton-under-Heywood at para 175, a specific concern in that case was the effect on settled transactions if those who had made payments on a legal basis which they were aware might be false could thereafter seek to recover those payments once the definitive legal position was established with the benefit of the extended limitation period for recovering amounts paid under a mistake provided by section 32(1) of the Limitation Act 1980.

417. However, on the formulation adopted by Lord Hoffmann (with the support of Lord Hope), where a payer takes the risk that the payment may not be due the effect is not simply to take the payment outside section 32(1) for limitation purposes, but to render the payment irrecoverable from the outset. This was confirmed by Lord Walker of Gestingthorpe in *Pitt v Holt* [2013] 2 AC 108, para 114, who further noted:

“It does not matter if the mistake is due to carelessness on the part of the person making the ... disposition, unless the circumstances are such as to show that he deliberately ran the risk, or must be taken to have run the risk, of being wrong.”

418. The editors of *Goff and Jones* at para 9-37 doubt that “‘assumption of risk’ should be elevated to the status of an independent bar”, noting that “[there] is also a danger that assumption of risk will only function as a conclusory label” (para 9-38). Frederick Wilmot-Smith has also criticised the circular nature of “assumption of risk” reasoning (because the payer can only be said to have taken the risk of non-recovery if there is no claim in unjust enrichment): “Replacing risk-taking reasoning” (2011) 127 LQR 613.

419. The cases in which the concept of “assumption of risk” has featured have generally involved attempts to recover mistaken payments or where one party does work in anticipation of the conclusion of a contract, rather than a case such as the present in which goods or services are provided pursuant to the terms of a contract which the parties purport to enter into but which is *2021 in fact void. Unjust enrichment claims of this kind are generally categorised as “failure of basis” claims, restitution being appropriate because the benefit was conferred on a joint understanding that the recipient's right to it was conditional on counter-performance. Where this basis for unjust enrichment is relied upon, and the failure of basis established, it might be thought that there is limited scope for the claim to fail because the claimant has assumed the risk of its failure. The very fact that the conferring of the benefit was, to the parties’ joint knowledge, conditional in this sense involves an allocation of risk, and one which is inconsistent with the party rendering the benefit having assumed the risk of the absence of counter-performance.

420. The attempt to distinguish between mistaken payment cases (where a claim in unjust enrichment would be precluded if the payer took the risk the payment might not in fact be due), and cases where the benefit is transferred on the basis of a void contract (where it would not) runs into the immediate difficulty that the cases concerned with ultra vires swaps (unlike those concerned with payments of tax demanded but not due) involve both elements. A party who has made payments under a swap agreement on the basis of a mistake that there is a binding contract has also made those payments on the basis that there will be counter-performance from the opposing party.

421. It is clear from the treatment of unjust enrichment claims in respect of payments made under wholly executed ultra vires swaps that the mere fact that the anticipated counter-performance has been received does not preclude a claim in unjust enrichment by the net payer based on the mistake as to the existence of the contract (*Guinness Mahon & Co Ltd v Kensington and Chelsea Royal London Borough Council* [1999] QB 215). This case can be seen as treating payments under void swap contracts as conditional in two respects: conditional on the receipt of counter-performance, but conditional also on the conclusion of a binding contract and the legal rights which would follow from that. I can see no objection in principle to the transfer of a benefit being subject to more than one condition, failure of any one of which will generate a claim in unjust enrichment. This analysis is supported by the editors of *Goff and Jones* (paras 13.14–13.15) and also by the Singapore Court of Appeal in *Benzline Auto Pte Ltd v Supercars Lorinser Pte Ltd* [2018] 1 SLR 239 , para 52 in which Judith Prakash JA observed: “[Although] it is usual and convenient to refer to *the* basis of a transfer, the reality is that, as the learned authors of *Goff & Jones* observe at para 13-14, a transfer may have more than one basis.”

422. In those cases where the claimant is aware of and can be taken to have assumed the risk that there is no binding contract, that may have the effect that the claimant cannot allege that the payment was conditional on the existence of a binding contract. However, it does not necessarily follow that a claimant who has assumed the risk that there is no binding contract has also assumed the risk of absence of counter-performance if the transfer of benefit is also conditional in this respect (as benefits provided on the basis of a void contract will generally be). This is an issue which is unlikely to arise in void swaps cases where the claim in unjust enrichment is invariably asserted by the net payer for the net payment, and the ultra vires argument will only be raised when the public body is “out of the money”. While Tomlinson J in *Haugesund Kommune v Depfa ACS Bank (Wibborg Rein & Co, Part 20 defendant)* [2010] Lloyd's Rep PN 21 , paras 142 and 145 *2022 described the suggestion that assumption of risk might operate differently as between different “unjust factors” as “a somewhat arid controversy”, and observed that the nature of the enquiry in respect of both mistake and failure of condition was “the same” on the case before him, he accepted that “that might not in all cases be so”.

423. Turning to the present case, the provision of the Building to the College was clearly conditional in the sense that it was the joint understanding of SFM and the College that it was to be paid for, and that the Building was being provided on the condition of such payment. That condition having failed in respect of the period after September 2017, SFM is entitled to a remedy in unjust enrichment. I do not believe that it would be an answer to that claim if it was not open to SFM to contend the transfer of benefit was also conditional in a second respect (namely that the Contract was binding) because SFM had taken the risk that the Contract was void. Each argument of failure of condition has to be considered on its own merits. The fact that the transferor had assumed a risk in relation to one matter, so as to preclude an argument that the transfer was conditional in that sense, is no reason why it cannot point to a different respect in which the transfer was subject to an unfulfilled condition.

424. In any event, in respect of the position up to judgment, I am satisfied that SFM cannot be said to have known of and chosen to take the risk that the Contract was not valid, whether that issue is approached subjectively or objectively (cf *Goff and Jones* , para 10-037). I accept Mr Spring's evidence that it was his belief when the Contract was concluded, and thereafter, that sufficient steps had been taken to ensure that the Contract was within the College's capacity. Just as this factual finding was conclusive of the position in *Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs* [2007] 1 AC 558 , so it is here. While it would not matter whether or not what I have found to be a mistaken understanding was the result of carelessness (cf

Pitt v Holt [2013] 2 AC 108, para 114), it is clear that Mr Spring took legal advice on the issue, and paid close attention to the terms of the Contract, all with a view to seeking to ensure it was appropriately classified as an operating lease and not a finance lease. While I accept that the desire to maximise profit meant that Mr Spring sought to get as close to the line as he could, I am quite satisfied that he took steps to ensure and firmly believed that SFM had not crossed it. I am also satisfied that the College could never have reasonably understood that, if the Contract proved to be outside the College's capacity, SFM intended to provide the use of the Building gratuitously.

How is any claim in unjust enrichment to be valued?

425. The proper approach to valuing a benefit conferred in these circumstances is set out by the Supreme Court in *Benedetti v Sawiris* [2014] AC 938. Lord Clarke JSC at para 34 concluded that “the starting point for identifying a benefit which has been conferred on a defendant, and for valuing that benefit, is the market price of the services”. That value would ordinarily be what a reasonable person in the position of the defendant would pay for the services provided (para 17), subject to considerations of subjective devaluation which do not arise in this case (para 18).

426. In cases where the parties proceed on the basis that they have concluded a contract for the provision of services, but in fact they have not, or where the parties are in negotiations for a contract which is not concluded, *2023 reliance is sometimes placed on the “contractually agreed” rate or the rate offered in negotiations as the best guide to the market value of the benefit conferred. In *Benedetti* Lord Neuberger PSC stated at para 168:

“in the absence of any other evidence or any good reason to the contrary, where two parties agree, at arm's length, that one of them will pay a certain sum, or at a certain rate, for a type of benefit to be provided by the other, there must be a prima facie presumption that that amount is, or at least is good evidence of, the market value of that type of benefit.”

427. However, in this case there is expert evidence of the market value of the benefit, albeit only from the defendants' expert, Mr Manley. His valuation—a figure rising from £250,000 per year in 2013 to £270,000 a year by 2019—is far removed from the amount which the College agreed to pay under the Contract, namely £667,841 plus VAT per year. In circumstances in which there is such a significant discrepancy between the Contract price and the objective evidence of value, the decision in *Benedetti* suggests that the contract price will only be of limited use in valuing the benefit. Lord Reed JSC (at paras 139–140) suggested that it would be important to know the reason for the discrepancy, which might reflect an imbalance in the bargaining skills of the parties. He cautioned against placing reliance on the agreed price “in the absence of any identified circumstances which could account for the divergence from the value indicated by other evidence”.

428. In this case, I am unable to place any significant reliance on the Contract price when valuing the benefit which the College has obtained for the following reasons:

- (i) First, as I have set out above, there is no evidence of the College taking any steps to seek to negotiate the prices proposed by BOSHire. It simply accepted the prices which were put forward. The comfort which a court may sometimes draw from a price arrived at between two parties bargaining at arm's length is absent here.
- (ii) Second, there is a very significant difference between the terms under the Contract—under which the College had the benefit of a 15-year period as hirers of the Building, an assignment of BOS's warranty as to the life of the modules, and a strong expectation, at the end of that 15-year period, of purchasing the Building—and the circumstances which prevail in the absence of a contract, in which the College's use of the Building is subject to the risk that BOSHire/SFM might request its return on reasonable notice at any time. As Lord Clarke JSC noted in *Benedetti* at para 99, any contract which the parties to the unjust enrichment claim have entered into “might have included many other terms and conditions besides a price”.
- (iii) Third, it is important that the valuation of the claimants' unjust enrichment claim remains consistent with the basis on which I have found that the Contract was beyond the College's capacity. I have found that the Contract was a finance lease because substantially all of the risks and rewards of ownership were assumed by the College. In valuing the benefit which the College received for the purposes of a claim in unjust enrichment, the price payable under a contract which the College lacked the capacity to enter into is, necessarily, a poor guide to the value of the benefits it did receive. For the purposes of the claimants' claim in unjust enrichment, those benefits fall to *2024 be valued on a fundamentally different basis (namely of benefits of a kind for which the College could have obtained by way of an operating lease), with the result that the economics of the benefit being valued are fundamentally different from those inherent in the Contract.
- (iv) In this regard, it is significant that while the use of property can constitute the transfer of benefit for the purposes of a claim in unjust enrichment when a contract for hire has been found to be unenforceable, no claim in unjust enrichment will

be allowed where this would be inconsistent with the policy which led to the contract of hire being void in the first place. It was for this reason that a claim in unjust enrichment for the benefit of using a car failed in *Dimond v Lovell* [2002] 1 AC 384, 397–398 when the hire contract was unenforceable under the Consumer Credit Act 1974. In this case, the Contract was void because it amounted to a finance lease and therefore borrowing. It would not be inconsistent with this finding to value the enrichment by reference to the market price of the right to use the Building under an operating lease. However, the ultra vires nature of the Contract counts strongly against any use of the Contract hire rate as evidence of market value.

429. In supplemental submissions which I asked the parties to file to address the College's claim in unjust enrichment, and which were filed on 1 April 2020, the claimants made the following comment on Mr Manley's valuation of their unjust enrichment claim:

“For the avoidance of doubt, the sum identified by Mr Manley at paras 6.15–6.27 and para 8.2 of his report (£250,000–£270,000) was reached by reference to rental of entirely incompatible buildings and did not consider the appropriate market value for the particular Equipment in question (which would obviously have been a great deal higher to account for the specifications and particularities by the College). This was not just a building but a series of relocatable structures compiled to the specific and exact specifications of the College.”

430. However in circumstances in which the claimants had not adduced any evidence themselves of the objective value of the benefit received by the College from possession and use of the Building, nor cross-examined Mr Manley on his evidence on this issue, it is not open to the claimants to advance these points some three weeks after trial concluded (whether “for the avoidance of doubt” or for any other purpose). In any event, the claimants still advanced no alternative figure save (implicitly) to contend that I should use the price payable under the Contract. For the reasons I have set out above, I am unable to place any reliance on that figure.

431. In these circumstances, the only evidence of the objective value of the benefits which the claimants provided to the College is that of the defendants' expert, Mr Manley of a market rate per annum of £250,000 in September 2013, rising to £270,000 per annum by November 2019. Accordingly I will ask the parties to agree a calculation of the benefit for each year of hire as follows:

- (i) For September 2013 to August 2014, £250,000.
- (ii) For each subsequent year from September 2014 to 4 September 2019, a figure which reflects a straight line extrapolation on the basis that the market value rose on a linear basis from £250,000 to £270,000 over that period. *2025
- (iii) For the period from 5 September 2019 to the date of judgment, a pro rata proportion of £270,000 per annum.

432. For reasons which I explain below, I am satisfied that SFM has a defence of change of position to the College's claim to recover payments from SFM. This raises an issue as to the interrelationship of SFM's and the College's claims in unjust enrichment. I return to that issue below after I have considered the College's claim in unjust enrichment.

For what period can SFM claim?

433. The unjust enrichment claim is pleaded on the basis that the College has been unjustly enriched by the retention of the equipment. The particulars of claim assert a claim in respect of unjust enrichment “to date”, albeit one only quantified “as of” 30 October 2018. The reply similarly notes that the claim for unjust enrichment is one brought “up to and including today's date (the College having insisted on wrongfully retaining the equipment)”.

434. In my view, this involves the assertion of a continuing claim for unjust enrichment for so long as the College continues to insist on retaining the Building. It follows that I reject the College's submission that SFM is only entitled on its statement of case to assert an unjust enrichment claim in respect of the period up to trial and not thereafter.

435. However, the position with regard to any claim by SFM following judgment gives rise to a number of potential difficulties.

436. First, once it is established that the Contract is void, it might be said that any complaint by SFM in relation to subsequent use of the Building by the College is properly the domain of the law of tort. SFM is able to assert its right as owner to recover the Building (albeit, given that the Contract is void, it cannot seek to enforce as it has previously a contractual obligation requiring the College to dismantle and return the Building). If the College refuses to comply with such a demand, then that is likely to

constitute conversion of the Building, triggering a right to user damages (see *One Step (Support) Ltd v Morris-Garner* [2019] AC 649, paras 25–30). If, however, SFM does not choose to seek to reclaim its property, it might be said that any continuing possession on the College's part is not the result of any unjust factor capable of supporting an unjust enrichment claim, but simply a consequence of SFM's own decision not to try and get its property back.

437. Second, if a claim in unjust enrichment is hereafter pursued in respect of the period after judgment, it might be argued that the College's continuing use of the Building after judgment does not involve a separate and independent transfer of value (cf *Prudential Assurance Co Ltd v Revenue and Customs Comrs* [2019] AC 929). In my view, the preferred analysis is that where the benefit conferred is not the transfer of property outright, but the transfer of the right of possession (and the concomitant right of use) of property which the transferor is entitled to terminate at will, it is appropriate to treat each period during which the right of possession and use subsists as an independent transfer of value. That would be consistent with the fact that the objective valuation of the benefit is itself time-dependent (viz a market rate for use for a particular period). That is very different from the position where there is an outright transfer of money or property, which the transferee subsequently uses (in which case the subsequent use of the money or property will not involve a further and independent transfer of value: cf Professor Stevens, "The Unjust Enrichment Disaster" (2018) 134 LQR 574, 596–597). *2026

438. Third, if an unjust enrichment claim is to be brought, the effect of my judgment is that it will not be possible for SFM to contend hereafter that it is conferring the right to possess and use the Building on the College on the basis of a mistaken belief as to the status of the Contract. However, for the reasons I have set out above, it may be said that that of itself does not preclude an unjust enrichment claim for the period after judgment. It might still be said that there was joint understanding that one of the conditions on which the Building was provided—that its use would be paid for—was a continuing condition, capable of operating even after it has been definitively determined that the Contract is void.

439. Finally, the position might arise in which SFM was offered a reasonable opportunity to disassemble and remove the Building, but refused to take it, raising the issue of whether use of the Building by the College thereafter would be capable of generating an unjust enrichment claim in circumstances in which it had made it clear it no longer wanted the Building (see the discussion in *Goff and Jones* at para 17-10).

440. These are potentially deep waters, which were not navigated at the trial, and which are best left for final determination as and when the precise facts prevailing in the period after judgment are known. The observations in paras 436–439 are not intended to determine any of these issues, but are made in the hope that they might be of some assistance to the parties in reaching agreement on the future position.

The College's counterclaim in unjust enrichment

441. The College also brings an unjust enrichment claim, seeking to recover the payments it has made. Its pleaded case is that it has made: (i) payments to BOSHire of £2,001,613.75 (inclusive of VAT) over the period November 2011 to January 2014; and (ii) payments to SFM of £2,003,522.40 (inclusive of VAT) over the period from August 2014 to September 2017.

442. The claim for repayment was originally advanced by the College solely against SFM (the only claimant at the relevant time), with the result that the defence of change of position to that claim was only pleaded by SFM. Once BOSHire and GCP were amended into the claim form as additional claimants, the College amended its counterclaim to seek repayment from all three claimants. However, no amendment was made to the change of position defence, which continued to be advanced only by SFM. This has led to extensive debate in post-hearing submissions as to whether the defence of change of position is available in respect of any of the payments, and thrown up a number of further issues which were not fully explored during the hearing.

How much was paid and to whom?

443. In a supplemental statement served on 10 February 2020, Ms Williams gave evidence about the invoices paid by the College, identifying amounts said to have been paid to BOSHire and amounts said to have been paid to SFM. *2027

444. The statement gave the following information:

Invoice No	Date	Amount	Supplier
BOS11884 [A]	30/11/2011	£36,000	BOSHire

BOS2268 [B]	12/02/2013	£348,000	BOSHire
BOS2286[C]	11/03/2013	£372,000	BOSHire
BOS2424 [D]	11/09/2013	£1,202,114.40	BOSHire
BOS2452C [E]	11/09/2013	(£720,000)	BOSHire
		CREDIT	
5395228 [F]	20/01/2014	£48,499.35	BOSHire
008 [G]	01/08/2014	£380,230.80	SFML
0010 [H]	03/09/2014	£20,473.20	SFML
0011 [I]	01/08/2015	£801,409.20	SFML
0012 [J]	22/08/2016	£801,409.20	SFML

I have added the letters in the first column to make it easier to identify the specific invoices under consideration in the discussion which follows.

445. Mr Spring said that payments A and F had been made to BOS and not to BOSHire. Mr Spring gave the following evidence about invoices D and E:

“ A . The two payments under 242 ... invoice numbers 2424 and 2425 ... were ... they ended up with BOSHire, but they were actually ... or they ended up with SFM rather.

“ Q . When you say ‘ended up’, do you mean?

“ A . Well, because I think Built Offshore actually ...

“ Q paid by them or ...

“ A . Yes, but BOSHire ended up with the money or SFM received the benefit of the cash but I think the invoicing was done on those two payments by Built Offshore, just as an accident of the way the administration worked.”

446. By the time closing submissions came to be made, there was no dispute that payment under invoice A issued in November 2011 was made to BOS. Further, the invoice was not paid pursuant to the Contract (which was not signed for another 16 months). In these circumstances, the College realistically accepted that it was not in a position to seek recovery of this amount against the claimants on the basis of a finding that the Contract was ultra vires. However, the position of invoices B to F remained in dispute.

447. It is clear from the documents that the invoices which Ms Williams had identified as having been paid to BOSHire were issued by BOS which provided its own bank account details for payment. It is also clear that the credit note which Mrs Williams identified as having been received from BOSHire was a credit note from BOS. That credit note was issued in the amount of £720,000 as a means of giving credit for the payments made under invoices B and C (which totalled £720,000), with the result that invoices B and C, and credit note E cancel each other out. For that reason, I do not consider them further. That leaves invoices D and F.

448. So far as invoice D is concerned:

(i) In supplemental closing submissions, the claimants produced a further invoice from SFM to BOS in the amount of invoice D, which was described as follows: “Hire charge for period from 05.09.13 to 04.09.14 due from Christ the King under hire contract ref 1022—invoiced by Built Offshore as agent.” *2028

(ii) As this invoice suggests, invoice D is in the amount of the first hire payment as set out in the September 2013 supplement to the Contract.

(iii) At the date this payment was made, BOS had no entitlement to it (because it was never a payee under the Contract) and BOSHire had no right to it because it had assigned its right to rent to SFM, and the College had been notified of that assignment.

(iv) The evidence of Mr Spring, with which the invoice produced by the claimants following the trial is consistent, is that this amount found its way to SFM.

(v) In these circumstances, I reached the provisional conclusion that invoice D was paid by the College to BOS who received it as agent for and accounted for it to SFM. However, given that the fact and transmission of the payments ought to be matters of record, I decided to allow the claimants and the College the opportunity to check the position before reaching a final conclusion. After checking the position, the College confirmed that invoice D had indeed been paid to BOS, with the College's accounting system showing that credit note E came from "Built Offsite Ltd" and that invoice D was paid to "Built Offsite Ltd". SFM provided a copy of its bank statement for the relevant period which confirmed that the amount had been accounted for by BOS to SFM.

449. That leaves invoice F which, on Mr Spring's evidence, was paid to BOS and not BOSHire and for which there is no evidence to suggest it was ever re-billed to SFM. I accept Mr Spring's evidence:

(i) As I have noted, invoice D was in the amount of rent due on the commencement date of the Contract. Similarly, invoices G and H, added together, are exactly equal to the amount of rent payable on the first anniversary of the Completion Date under the Contract. Invoices I and J respectively are equal to the payments due under the Contract in September 2015 and September 2016 respectively.

(ii) By contrast, invoice F is not referable to any amount payable under the Contract. This corroborates Mr Spring's evidence that this amount was not paid under the Contract.

(iii) In these circumstances, I have concluded that the College had no right to recover the amount paid under invoice F, which (a) was not paid under the Contract, and therefore is not susceptible to a claim in unjust enrichment on the basis that the Contract was void; and (b) was not paid to or for the benefit of SFM, but to BOS.

450. As I have noted, through the RSA, SFM entered into an agreement to assign its right to payments under the Contract to GCP. The effect on that purported assignment of my conclusion that the Contract was void, with the result that SFM had no right to rent to assign, was not explored before me. The notice of the assignment given to the College provided that the College should make payments into a bank account in the name of GCP, but also provided that the College should continue to deal with SFM until they had received written notice from GCP to the contrary. Further, the invoices in question were issued by SFM and not by GCP.

451. As I have noted, the College's evidence was that it made the payments to BOSHire or SFM. The College's case in opening was that "no payments were in fact ever made to GCP", and its case in closing was that the amounts it had paid fell "to be recovered from BOSHire and SFM" and *2029 that "no payments were made to GCP". That remained the College's position in the further submissions which I asked it to file after the hearing.

452. In these circumstances, I have concluded that I should proceed on the basis that the College's unjust enrichment claim is being advanced against BOSHire and SFM, and I have not considered the issues which would arise if the claim were to be advanced against GCP instead. If, however, I had concluded that it was necessary to consider the College's unjust enrichment claim on the basis that GCP was the appropriate defendant, I would have given GCP the opportunity to make an application for permission to amend to advance a change of position defence.

453. In summary:

(i) The College cannot bring an unjust enrichment claim in respect of invoices A and F.

(ii) The College can bring an unjust enrichment claim in respect of invoices D, E, G, H, I and J in the total amount of £2,485,636.80 inclusive of VAT, and the appropriate defendant to those claims is SFM.

454. Unless SFM can establish one of the recognised defences to an unjust enrichment claim, the College is entitled to recover these payments. The basis of the claim can be analysed in a number ways: that the payments were made under a mistake of law or subject to a condition (which failed) that the College was acquiring legal rights (*Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349) or under the principle in *Auckland Harbour Board v The King* [1924] AC 318 that ultra vires payments by a public body are recoverable in unjust enrichment.

455. The only defence advanced to the College's claim in unjust enrichment is the defence of change of position.

SFM's change of position defence

Is it open to SFM to advance a change of position defence, and if so what basis?

456. SFM's pleaded change of position defence is as follows:

“It is averred that SFM has, in good faith, changed its position. In particular, it is averred that such sums as were received as hire charges pursuant to the terms of the hire contract have been spent, in good faith and in the honest belief that the hire contract was not ultra vires, on servicing its financial obligations arising out of the manufacture, commissioning, transportation, and construction costs involved at the beginning of the hire contract.”

457. The College's unjust enrichment claim, and SFM's defence to it, were not addressed in the claimants' opening skeleton argument. For its part, the College's opening skeleton argument provided:

“It is understood from the claimants' defence to counterclaim that SFM (alone) pleads a change of position defence by reference to ‘servicing its financial obligation arising out of the manufacture, commissioning, transportation, and construction costs involved at the beginning of the Hire Contract’. No evidence has been advanced in this respect on behalf of SFM, which has provided no disclosure as to its finances at all, and the College does not presently understand the basis for a change of position defence.” *2030

458. In this case, the pre-trial directions provided for the service of supplementary opening skeletons. The claimants' supplemental skeleton did not respond to that allegation, or otherwise address the College's claim in unjust enrichment.

459. As the College's opening skeleton rightly observed, no witness evidence was adduced by the claimants which directly addressed the change of position defence. While Mr Spring gave some evidence as to the financial arrangements between the claimants and the structure of the transaction on the claimants' side, he did not engage in any detailed explanation of what amounts SFM had paid and when.

460. In its written closing submission, SFM explained its case as follows:

“SFM was, under both the deed of assignment and RSA, responsible for the costs of manufacture, commissioning and transportation and construction costs in relation to the equipment. The College criticises the claimants for failing to advance evidence on this change of position (which is blindingly obvious from the fact of the buildings themselves and the construction of the RSA and the deed of assignment). No further evidence is necessary. SFM might potentially have advanced receipts for expenditure, however, there is ample evidence already before the court which demonstrates that the costs expended by SFM in installing and erecting these units were considerable and far in excess of the hire charges paid under the Contract.”

461. The only evidential reference given to support the paragraph was a reference to the expert evidence of Mr Dodson which addressed the cost of the Building, but not who had paid for it. No other submissions were made (legal or factual) and no other evidential references were given.

462. The editors of *Goff and Jones* observe at para 27.32:

“The onus of pleading and proving the change of position defence is on the defendant, who must put it forward ‘fairly and squarely’ in his statement of case so that ‘its factual merits can be explored at trial’; he must also adduce evidence and give disclosure in support of the defence” (quoting from *Adrian Alan Ltd v Fuglers [2003] 4 Costs LR 518*, para 16 and *Prudential Assurance Co Ltd v Revenue and Customs Comrs [2017] 1 WLR 4031*, para 150).

463. I have given careful consideration to the question of whether it should be open to SFM to pursue its change of position defence, given the limited attempts to develop the point in argument at trial or to point the court to any evidence said to support it. However, there are a number of documents in the chronological bundle which are capable of supporting such a defence in the form it was advanced in SFM's written closing (ie a defence premised on the amounts paid by SFM for the construction of the Building). In these circumstances, I decided to allow a further round of written closing submissions on the change of position defence as formulated in the claimants' written closing. The claimants filed 19 pages of submissions. The College served a responsive submission of some 11 pages, to which the claimants replied in a further eight-page document served on 8 April 2020.

464. Understandably, the College has objected to the claimant's failure to develop their change of position defence adequately at trial. In particular **2031* the College relies on paragraphs J8.6–J8.7 of the current edition of the Commercial Court Guide, which provides that not all documents in the trial bundle are in evidence, and that a claimant wishing to put a document in the trial bundle into evidence must “actively adduce the document in evidence by some other means”. The Guide also provides that “it will not normally be appropriate for reliance to be placed in final speeches on any document not already specifically adduced in evidence by one of the means described” (the parties' agreement, an invitation to the judge to read the document in opening or putting the document to a witness).

465. This provision is clearly intended to ensure that the judge and the parties have a fair opportunity to comment upon documents which one party (or indeed the judge) relies upon, and to take up any issues which arise in relation to those documents either with a relevant witness or in submission. In this case, while there was no specific reference to the various interim payment documents in opening, the expert report of Mr Dodson, which was adduced in evidence, did refer to and rely on BOS's invoices and Bailey Partner's valuations, and Mr Dodson's evidence on the costs of construction was not challenged. Given the narrow nature of the issue, and the absence of any genuine controversy between the parties in relation to the cost of the Building, I have concluded that I can fairly rely upon these documents for the purpose of my judgment now that the College has been afforded, and taken, an opportunity to make submissions about them.

SFM's change of position defence: the law

466. So far as SFM's change of position defence is concerned, the applicable legal principles can be briefly stated:

- (i) There is a defence of change of position to a claim in unjust enrichment where the defendant's “position has so changed that it would be inequitable in all the circumstances to require him to make restitution, or alternatively to make restitution in full”: *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548 , 580.
- (ii) A change of position can be established from action taken before, but in anticipation of, the receipt of the payment: *Dextra Bank and Trust Co Ltd v Bank of Jamaica* [2002] 1 All ER (Comm) 193 , para 38; *Commerzbank AG v Price-Jones* [2003] EWCA Civ 1663 at [38], [47].
- (iii) “[The] mere fact that the defendant has spent the money, in whole or in part, does not of itself render it inequitable that he should be called upon to repay, because the expenditure might in any event have been incurred by him in the ordinary course of things”: Lord Goff of Chieveley in *Lipkin Gorman* , at p 580.

467. The change of position which SFM advanced in closing at trial was based on the fact that it had paid for the acquisition and construction of the Building which had happened by November 2013. The College did not seek to argue that a defence of change of position was not open to SFM to the extent that its claim in unjust enrichment was premised on a failure of basis, no doubt recognising that the nature of the change of position relied upon in this case was expenditure directly incurred in preparation for the Contract (see the discussion in *Goff and Jones* , at paras 27-58 to 27-60).

468. However, the payments which the College seeks to recover from SFM include payments made after the last amount was paid to BOS. As I noted above, the Privy Council held in *Dextra* that the fact that the change **2032* of position occurs before rather than after the receipt in question does not preclude a change of position defence. The Privy Council observed at para 38:

“It is true that, in the second case, the defendant relied on the payment being made to him in the future (as well as relying on such payment, when made, being a valid payment); but, provided that his change of position was in good faith, it should provide, pro tanto at least, a good defence because it would be inequitable to require the defendant to make restitution, or to make restitution in full.”

469. The Court of Appeal in *Commerzbank AG v Price-Jones* [2003] EWCA Civ 1663 at [38] and [47] has also confirmed that reliance in anticipation of the receipt of a payment which is then received can establish the defence of change of position.

470. The College argued that the defence of change of position cannot be advanced by way of a defence to a claim by a public body to recover monies paid out under an ultra vires contract where the change of position in question was effected in anticipation of, rather than following, receipt of the payments in question. The College relied upon the decision Clarke J in *Svenska* [1995] 1 All ER 545, in which the judge rejected a defence of change of position by the bank premised on a hedging swap which the bank had entered into at the same time as the void swap and in reliance upon the validity of the swap agreement with the local authority. The local authority submitted that the change of position in question had occurred when the hedge was taken out, which preceded the receipt by the bank of any payments from the local authority. At p 565, Clarke J accepted the local authority's argument:

“In my judgment in circumstances such as these the bank is not entitled to rely upon the underlying validity of the transaction either in support of a plea of estoppel or in support of a defence of change of position. That is because the transaction is ultra vires and void. It is for that reason that in a case of this kind, save perhaps in exceptional circumstances, the defence of change of position is in principle confined to changes which take place after receipt of the money. Otherwise the bank would in effect be relying upon the supposed validity of a void transaction ... It does not however follow that the defence of change of position can never succeed where the alleged change occurs before the receipt of the money.”

471. The Privy Council in *Dextra* [2002] 1 All ER (Comm) 193 observed of this passage at para 39:

“It follows that the exclusion of anticipatory reliance in that case depended on the exceptional facts of the case; though it is right to record that the decision of Clarke J has been the subject of criticism—see, eg, *Goff and Jones*, *Law of Restitution* ... pp 823–824.”

472. It is not clear which “exceptional facts” the Privy Council thought might justify the exclusion of anticipatory reliance in that case. The editors of *Goff and Jones* suggest that it might be that the payment of money under a back-to-back hedging contract with another bank was too remote (para 27-36, footnote 101). However, the terms of Clarke J's judgment suggest *2033 that he attached particular significance to the fact that the swap with the local authority was void, and took the view that allowing a defence of anticipatory change of position in those circumstances would involve the bank establishing change of position in reliance on the existence of the swap contract (and therefore on an ultra vires transaction) rather on the fact of payment (which had yet to occur).

473. There can be no objection in principle to allowing a party who receives an ultra vires payment from a public body to advance a change of position defence. The editors of *Goff and Jones*, at para 27-64, suggest that “the recipients of ultra vires payments by public bodies should be allowed to raise the defence of change of position on appropriate facts”. They also note that the defence has been upheld in response to claims by local authorities to recover amounts paid under ultra vires redundancy agreements in *Hinckley* [2000] LGR 9 and *Eastbourne Borough Council v Foster* 20 December 2000. As the defence does not involve holding a public body to a representation as to its ability to make a payment which it is outside its capacity to make, but rather a defendant-focused inquiry in circumstances in which the public body is asserting a cause of action to recover the amounts paid, the recognition of the change of position defence does not subvert the principle propounded by the House of Lords in *Howell v Falmouth Boat Construction Co Ltd* [1951] AC 837, 844–845 that the ultra vires doctrine cannot be subverted by allowing payees to hold public bodies to false statements by public officials as to the bodies' vires.

474. The College did not contend “that a change of position defence can never arise in a restitution claim based on ultra vires”, and it accepts that in cases not involving public authorities, anticipatory change in position can give rise to the defence. However, it contends that there can be no anticipatory change of position defence to claims to recover ultra vires payments by public bodies. The College argues that:

“In an anticipatory change of position context, giving effect to the defence has the effect of holding that the public authority was legally required to make the ultra vires payments it then subsequently made. That is an infringement of the ultra vires doctrine in the way that recognising that a payment made ultra vires which is subsequently spent, cannot be recovered is not.”

475. In my opinion, this submission proceeds on a misapprehension. The recognition of the defence of anticipatory change of position does not place a party under an obligation to make payments for which the legal basis has not been satisfied, simply because the other party has acted in anticipation of the receipt of such payments. If the failure of basis comes to the putative payer's attention before the payment is made, there will be no obligation to make the payment, whether or not there has been anticipatory reliance. If, however, the party makes the payments in ignorance of the failure of basis, and then requires the court's assistance to recover the payment back, the defence of anticipatory change of position may provide an answer to such a claim, in whole or in part. As the Privy Council noted in *Dextra [2002] 1 All ER (Comm) 193*, para 38: “Since ex hypothesi the defendant will in fact have received the expected payment, there is no question of the defendant using the defence of change of position to enforce, directly or indirectly, a claim to that money.” *2034

476. I note that Cranston J allowed a defence of anticipatory change of position to be advanced in response to a claim to recover payments under an ultra vires contract in *Charles Terence Estates [2012] PTSR 790*, stating at para 98: “It does not matter that on some occasions that change of position occurred before CTE received the moneys, since it did so in anticipation of their future payment.”

477. Further, the defence of anticipatory change of position, as explained in *Dextra* and *Commerzbank [2003] EWCA Civ 1663* does not rest on the payee's reliance on the validity of the void transaction, but on the payee's reliance on the future payment (as the Privy Council observed in *Dextra*, para 38, “it is surely no abuse of language to say, in the second case as in the first, that the defendant has incurred the expenditure in reliance on the plaintiff's payment”). It is for this reason that the operation of the defence in these circumstances is sometimes described as one of “anticipatory reliance” (on the payment yet to be made) rather than actual reliance (on the existence of an obligation to effect the payment): see for example *Commerzbank*, para 38, in which Mummery LJ stated:

“As was held by the Judicial Committee of the Privy Council in the *Dextra Bank* case at p 204, the question whether it would be inequitable to require restitution can arise in cases of ‘anticipatory reliance’ where a recipient of an overpayment has already changed his position in good faith in the expectation of receiving a future benefit.”

478. For these reasons, I have concluded that there is no principled basis for the distinction which the College invites me to draw in its submissions between anticipatory and consequential change of position in public authority cases.

SFM's change of position defence: the facts

479. The College are right to observe that SFM's change of position defence received little attention in the course of the trial. However, the documents in the trial bundle clearly establish the following:

- (i) On 30 April 2013, SFM entered into a contract with BOS under which BOS agrees to erect the Building for the contract sum of £6,660,000 (“the Build Contract”). Variations led to the price being increased to £7,147,039.
- (ii) “Notification of Interim Payment” were provided by the Bailey Partnership, the construction consultants responsible for certifying when payments had been earned under the Build Contract, to SFM on 30 April 2013 (£1,892,715 plus VAT); 13 June 2013 (£3,598,640·15 plus VAT); 7 August 2013 (£767,210·85 plus VAT) and 20 November 2013 (£888,473 plus VAT).
- (iii) Invoices were rendered by BOS to SFM on 17 May 2013 for £900,000 plus VAT; on 13 June 2013 for £695,461·29 plus VAT and on 7 August 2013 for £339,538·71 plus VAT.
- (iv) On 13 September 2013: (a) SAM invoiced SFM for £222,491 for arrangement fees for the term and construction funding facilities. Mr Spring's e-mail of 12 September 2013 records that SFM invoiced SAM at or around the same time in the amount of £95,518. (b) SFM rendered invoices to BOS of £766,039 plus VAT and £597,683 plus VAT. (c) BOS rendered a further invoice to SFM of £5,319,984 plus VAT (which invoice referred to the fact that £1,935,000 plus VAT had already been invoiced). *2035

(v) On 20 November 2013, a further interim payment notice was issued by the Bailey Partnership for an amount due from SFM to BOS of £888,473. The notification referred to a total valuation of work done by BOS for SFM under the contract of £7,147,039, of which £6,258,566 had already been notified.

480. The College argued that there was no evidence that any of the invoices had actually been paid. It relies in this connection on a statement in *Goff and Jones*, at para 27-32, sourced to the New Zealand case of *Saba Yachts Ltd v Fish Pacific Ltd [2006] NZCCLR 963*, that it is not enough that there is “evidence that an invoice was issued by the defendant’s business associate, unaccompanied by evidence that this was ever paid”. In *Saba Yachts* the defendant had relied upon an invoice rendered by a related company for work alleged to have been done. Winkelmann J at para 65 suggested that production of an invoice at arm’s length might have been sufficient to prove a change of position because “if an invoice is issued, it is to be inferred that it is to be paid”. However, she was not prepared to draw that inference on the facts before her.

481. The issue of whether there is sufficient evidence to establish the defence of change of position is ultimately one of fact. I am satisfied on the evidence in this case that the overwhelming likelihood is that the invoices were paid:

- (i) There is clear evidence of the work done by BOS (in contrast to the position in *Saba Yachts*).
- (ii) The invoices were produced as a result of formal certification by the Bailey Partnership as an independent third party.
- (iii) The commercial arrangements which Mr Spring describes in his witness statement could only work if BOS was paid for the Building which was then leased by the acquirer to the College. It was Mr Spring’s evidence that the purpose of the various arrangements put in place was “to fund the purchase of the Buildings from [BOS] to that they could be leased to the end-customer”.
- (iv) The Notifications of Interim Payments all provided for payment within a specified period of time, were all issued following an application by BOS for an interim payment, and in each case BOS then invoiced SFM for the payments. I can think of no sensible reason why BOS, having sought an interim payment, established its entitlement to the same and then issued an invoice, would not have sought and obtained payment of the amounts certified.
- (v) It is clear from documents in the trial bundle that when SFM was late in making payments, BOS chased SFM and demanded payment by return. By way of example, in an e-mail concerning the third interim payment in August 2013, Mr Pierce informed Mr Spring “payment would now be appreciated, it so offends when we come to remove furniture, fittings and personal effects”.
- (vi) Finally, the terms of BOS’s invoices provided that property did not pass until payment. As I have noted above, it is clear on the evidence that SFM became the owner of the Building.

482. On this basis, I am satisfied that SFM made a net payment to BOS in anticipation of the receipt of rent under the Contract of in excess of £5.7m plus VAT and a net payment to SAM on the same basis of in excess of £125,000. *2036

483. In their second round of closing submissions, filed on 1 April 2020, the claimants also argued that SFM had borrowed and paid money in reliance on the receipt of payments from the College under the Contract and that this constituted a change of position. As the amounts paid by SFM to BOS for the Building, and for which I have invoices and/or notifications of interim payment, are sufficient to establish a change of position defence in respect of all of the amounts paid by the College to SFM, it is not necessary for me to address this alternative ground for a change of position defence.

Has a sufficient causal link been shown between the payments made by SFM and the receipt of payments from the College

484. The College contends that no sufficient causal link has been established between any payments made by SFM, and the receipt of hire charges, and also suggests that SFM took the risk in relation to any transaction it entered into.

485. So far as the amounts expended by SFM in paying for the acquisition, transportation and installation of the Building are concerned, it is clear on the evidence that SFM incurred this expenditure in reliance on, and anticipation of, the prospective payments under the Contract:

- (i) SFM was a single purpose company specifically incorporated for the purposes of this Contract.
- (ii) The Contract specifically contemplated that the Building would be acquired from BOS for the purpose of leasing it to the College.
- (iii) The College was made aware that SFM was the assignee of the right to hire and was to acquire ownership of the Building which the College was leasing in return for the payment of hire.

486. There is a very strong link between the expenditure relied upon as constituting change of position and the enrichment which the College seeks to reverse in this case: much stronger, for example, than the position where a party incurs expenditure influenced by a general sense of well-being because it anticipates receiving payments in the future; or (as in *Svenska [1995] 1 All ER 545*) where the payee enters into a back-to-back contract for its own purposes and to manage its own risk in respect of the transaction it has purported to enter into with the payer; or (as in *Haugesund Kommune v Depfa ACS Bank [2012] QB 549*) where the payee speculates for its own purposes using money paid to it under an ultra vires contract.

487. None of the matters relied upon by the College in its submissions of 7 April 2020 negate the clear and direct connection between the payments relied upon as constituting the change of position and the amounts which the College seeks to recover. Taking them in turn:

(i) The reasons for the assignment to SFM are clear on the evidence (viz that GCP wanted the rights held by a single purpose entity over whose assets it could have a debenture). In any event, uncertainty on this topic would not bear on the issue of whether SFM had made the payments for the Building to BOS in anticipation of the receipt of payments for the Building from the College.

(ii) The facts that there was some interchangeability between BOS and BOS Hire in the parties' contemporary dealings, that BOS was prepared to incur significant expenditure without a written contract in place and that BOS was willing to accept a reduced margin do not begin to establish that *2037 SFM would have paid for the Building without anticipating the receipt of hire under the Contract.

(iii) The fact that payments for the period up to 1 August 2014 were paid by the College to BOS and not to SFM lends no support to the suggestion that SFM would have been willing to pay for the Building otherwise than in anticipation of the College's legal obligation to pay hire. On the unchallenged evidence of Mr Spring, and as confirmed by a copy of the notice of assignment signed by BOS Hire and acknowledged by the College, SFM had the benefit of an assignment of all BOS Hire's rights under the Contract by 14 May 2013, long before the first payment of hire under the Contract fell to be made.

Does SFM have a surviving asset which defeats the defence of change of position?

The legal principles

488. Finally, the College contends that the amounts received by SFM from GCP under the RSA constitute a "surviving asset" which negates SFM's contention that it has changed its position. This argument raises a relatively under-developed aspect of the law of unjust enrichment first averted to by Lord Templeman in *Lipkin Gorman [1991] 2 AC 548*, 560 when he noted:

"Thus if the donee spent £20,000 in the purchase of a motor car which he would not have purchased but for the gift, it seems to me that the donee has altered his position on the faith of the gift and has only been unjustly enriched to the extent of the secondhand value of the motor car at the date when the victim of the theft seeks restitution. If the donee spends the £20,000 in a trip round the world, which he would not have undertaken without the gift, it seems to me that the donee has altered his position on the faith of the gift and that he is not unjustly enriched when the victim of the theft seeks restitution."

489. It will be noted that Lord Templeman's example focused on surviving value at the date restitution was sought, and not the mere acquisition of value in the past which could no longer be realised (viz the round-the-world trip). The issues raised by the potential counter-defence of "surviving value" are discussed in *Goff and Jones*, at paras 27-16 to 27-23. The editors refer to the decision of the High Court of Australia in *Australian Financial Services & Leasing Pty Ltd v Hills Industries Ltd (2014) 253 CLR 560*, paras 23-25 and 95 that a test of "irreversible detriment" should determine whether a defendant's circumstances have changed to such an extent that he should be entitled to the defence of change of position. However, the editors endorse Henderson J's observations in *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs (formerly Inland Revenue Comrs) [2015] STC 1471*, para 354:

"... It may be relevant to consider whether the expenditure or loss relied upon is reversible, and (if so) how easily the defendant could take steps to reverse it ... But it would be wrong to elevate this consideration into a general test of irretrievability. Expenditure may well be irretrievable, for example because it is immediately consumed, or for some other reason cannot be recouped from the payee, but that fact alone does not stamp the expenditure as a relevant disenrichment. *2038 Among other things, it also has to satisfy the causal 'but for' test if the defence is to be made out."

490. Professor Burrows QC also questions the suggestion that reversibility should be the touchstone of whether steps taken by the payee in anticipation of or as a result of a payment give rise to the defence of change of position, suggesting that the defence is concerned with “the defendant being in a worse position to pay back the money than he would have been in had the payment not been received” (or, presumably, anticipated): *The Law of Restitution*, 3rd ed (2010), pp 531–532.

491. The discussions of surviving assets, and most of the cases, are generally concerned with cases of exchange, in which the enrichment (or its anticipation) causes the payee to exchange money for an asset of some other kind—a car, shares and furniture, for example—or to effect an immediate reduction of an existing liability (paying an existing debt). The principle has also been applied to readily reversible unilateral payments—for example where payments have been made to tax authorities which are recoverable (eg *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862, 904). However, the transaction said to constitute the change of position may be more complex, involving the assumption on the part of the payee of additional liabilities beyond payment in return for the acquisition of an asset or the discharge of a debt. In that case, it may be much more difficult to conclude that there would no net adverse change in the payee's position if the payment was recovered.

SFM's acquisition of the Building

492. The first surviving asset which the College suggest defeats SFM's change of position defence is the Building. I accept that this comes very close to the specific example which Lord Templeman gave in *Lipkin Gorman* [1991] 2 AC 548 of an asset acquired on the basis of the receipt of funds which the payer then seeks to reverse.

493. However, I have accepted the College's case that the realisable value of this asset—which in the circumstances must mean its ex situ value—at the date restitution is sought is negligible, and certainly nowhere near sufficient to reduce the net level of payments which SFM has made to BOS below the amounts which the College seeks to recover *2039 from SFM. Giving credit for the realisable value of the Building does not reduce SFM's net expenditure below the amount which the College seeks to recover. That finding is sufficient in itself to defeat this aspect of the College's argument.

494. Further, the evidence establishes that SFM sold residual interest participations in the building to BOS and SAM for payments which I have already taken into account when calculating the level of net payments made by SFM. The effect of that sale is that it is BOS and SAM who stand to benefit from the future exploitation of the Building on the expiry or early termination of the Contract.

The amounts received by SFM from GCP

495. The College also alleges that SFM has not changed its position to its detriment because SFM sold the right to receive rent to GCP for a lump sum under the RSA. While the amount paid by GCP to SFM under the RSA was redacted from the copy before the court, it is clear on the evidence that this figure substantially exceeded the amount which the College seeks to recover from SFM. A valuation report provided by Mazars to GCP referred to GCP raising around £5m from a loan note issue all of which would be paid by GCP to SFM under the RSA

496. I have concluded that the circa £5m payment does not have the effect of reducing or eliminating the change of position defence which SFM has prima facie established in the form of the payments made to BOS for the Building.

497. The RSA involved SFM providing a series of promises to GCP in return for the payment, including transfer of the right to payment under the RSA “with full title guarantee”, and, inter alia, warranties at the date of the RSA and on completion that (i) the Contract was subsisting, valid, binding and fully enforceable; (ii) SFM had good and marketable title to the rent payable under the Contract; and (iii) the College had no defence to claims for the rent. It would be unrealistic to consider the benefit acquired by SFM under the RSA in isolation from the liabilities assumed by SFM in return. Once those liabilities are taken into account, it cannot be said that the amount received by SFM under the RSA negates the change of position prima facie constituted by SFM's payments to BOS.

498. Further, if regard is to be had to the RSA in assessing whether SFM has (in the College's words) “suffered a detrimental change of circumstances” in anticipation of the receipt of payments from the College, then it is necessary to step back and

consider the overall net effect of the transactions which SFM has entered into. Those transactions involved SFM transferring any entitlement to payments under the Contract to GCP and making certain promises to GCP in return for the payment of a lump sum. That lump sum was used by SFM (a) to repay the construction facility which was the principal source of the amounts SFM paid to BOS before completion of the Building and (b) to pay BOS the amounts falling due on completion. In net terms, therefore, SFM has acquired the Building, for which it has expended an amount in excess of the sum received from GCP. In circumstances in which I have found that the Building has an insignificant realisable value *ex situ*, and SFM has in any event sold the benefit of any residual value in the Building, the inevitable result of ordering SFM to repay the amounts sought by the College would be to leave SFM out-of-pocket by that amount, even before account is taken of the legal liabilities which SFM has assumed under the RSA.

499. For these reasons, I reject the College's "surviving value" argument, and find that SFM has made out its change of position defence to the College's claim in unjust enrichment.

The relationship between SFM's and the college's claims in unjust enrichment

500. I have found that:

- (i) SFM conferred a benefit on the College in respect of the period from September 2013 to trial.
- (ii) The payments made by the College for that benefit in respect of the period from September 2013 to September 2017 are not recoverable because SFM has changed its position in anticipation of those payments.

501. What is the combined effect of those findings?

502. In relation to the period from September 2013 to September 2017, SFM can make no further recovery beyond the amounts which the College has already paid and which I have held it cannot recover. This result can be **2040* rationalised in a number of ways. It might be said that SFM has received the anticipated counter-performance in circumstances in which the College cannot recover it (because of SFM's change of position defence), and so there has been no failure of condition. Alternatively, it might be said that any enrichment has not come at SFM's expense because SFM had been paid for it. In the further alternative, it might be said that in circumstances in which the College cannot recover back the amounts paid by way of rent for this period because of SFM's change of position, the College has its own change of position defence to any claim in unjust enrichment by SFM for that period.

503. In respect of the period from September 2017 to trial, I have concluded that SFM can recover in unjust enrichment at the market rate I have set out above. It is no answer to such a claim that, in respect of the preceding three years, the College will have paid in excess of the market rate. In circumstances in which the College cannot recover the rent paid during the preceding period because SFM has changed its position, it would not be appropriate to allow the College nonetheless to rely upon those payments as, in effect, creating a credit which can be used to answer SFM's claim in unjust enrichment in respect of later years for which no payment has been made.

504. It will be apparent that my analysis treats the unjust enrichment claim for each year's hire as, in effect, severable for the purposes of analysing the claims and defences to claims in unjust enrichment. In my view, this analysis best represents the nature of the benefit transferred—the possession or use of property over a period of time—and the market valuation of that benefit (which involved a period-dependent payment). It is for this reason that the amounts paid by the College for the period from September 2013 to September 2017, and which I have found to be irrecoverable, do not provide a complete answer to SFM's claim in unjust enrichment for the entire period of use of the Building (cf the rule that a failure of basis must be total unless the benefit conferred is severable analysed in *Goff and Jones*, paras 12-26 to 12-28).

The college's and the council's Part 20 claims against each other

505. The College's [Part 20](#) claim against the Council was premised on the College acting as the Council's agent in entering into the Contract, a premise which I have rejected. Accordingly this claim fails.

506. The Council's [Part 20](#) claim against the College was conditional on the Council being found liable to the claimants, which I have found it is not. Accordingly, the basis of this claim does not arise.

Conclusion

507. For the reasons set out in this judgment:

- (i) The Contract was ultra vires the College, with the result that the claimants' claims against the College under the Contract fail.
- (ii) The claimants' claims against the Council under the Contract fail, for that reason and for the additional reason that the Council was not a party to the Contract.
- (iii) The claimants' claims in misrepresentation and misstatement against the College and the Council fail.
- (iv) The College's claim to recover the amounts set out in Ms Williams's second witness statement from the claimants in unjust enrichment fails. **2041*
- (v) SFM's claim in unjust enrichment against the College succeeds in respect of the period from September 2017 to judgment, and is to be quantified on the basis set out in this judgment.

508. The parties are asked to seek to reach agreement on the terms of an order reflecting the findings in this judgment, and on any consequential issues. Directions will be given for further submissions to be filed on any matters which remain in dispute.

Louise Hopson, Solicitor **2042*

Declaration granted that contract ultra vires college and void.

College liable to first claimant in restitution for unjust enrichment in sum of £711,323.88, plus accrued interest in sum of £46,225.60. Payment stayed pending determination of college's appeal.

Claimants' claims against council dismissed.

College's counterclaim against claimants dismissed.

No order on college's and council's Part 20 claims.

Claimants' application for permission to appeal refused.

College's application for permission to appeal granted.

No order for costs as between claimants and college, or as between college and council.

Claimants to pay 95% of council's costs of claims against it on standard basis, to be assessed if not agreed, plus interest, with payment on account in sum of £332,000.

Footnotes

- 1 [School and Early Years Finance \(England\) Regulations 2012, reg 22](#) : "(1) ... where two or more schools are federated under [section 24](#) of the 2002 Act, the local authority must determine a budget share for each school in accordance with [Part 3](#) of these Regulations."
- 2 [School Standards Framework Act 1998, ss 48, 49](#) , as amended: see post, paras 70, 71.
- 3 [Education Act 2002, Sch 1, para 3](#) : see post, para 64.

(c) Incorporated Council of Law Reporting for England & Wales

Exhibit 9

*681 In re Spectrum Plus Ltd (in liquidation)



Positive/Neutral Judicial Consideration

Court

House of Lords

Judgment Date

30 June 2005

Report Citation

[2005] UKHL 41

[2005] 2 A.C. 680



House of Lords

Lord Nicholls of Birkenhead , Lord Steyn , Lord Hope of Craighead , Lord Scott of Foscote , Lord Walker of Gestingthorpe , Baroness Hale of Richmond and Lord Brown of Eaton-under-Heywood

2005 April 25, 26, 27, 28; June 30

Company—Debenture—Charge over book debts—Charge expressed to be "by way of specific charge" prohibiting disposal of book debts and requiring proceeds to be paid into account with chargee bank—Bank permitting company to draw proceeds of debts from account to use in course of business subject to restrictions—Whether charge fixed or floating

Judicial precedent—House of Lords decision—Effect—House of Lords overruling previous decision of lower court—Whether jurisdiction to overrule prospectively only

The company opened an account with the bank and obtained an overdraft facility for the purpose of providing working capital for the business of the company. By a debenture the company created a charge, expressed to be "by way of specific charge", in favour of the bank over the company's book debts in order to secure moneys due from the company to the bank. The obligations of the company under the debenture were to pay the proceeds of any book debt into the company's account with the bank, not to sell, factor, discount or otherwise charge or assign any such book debt in favour of any other person without the consent of the bank and, if called on to do so, to execute legal assignments of such book debts. The bank advanced £200,000 to the company and debited its new account accordingly. While the overdraft facility varied from time to time the company's account was never in credit. The proceeds of the book debts were collected by the company and paid into its account with the bank, thereby reducing the overdraft. The company drew on the account as and when required, thereby increasing the overdraft. The company went into creditors' voluntary liquidation owing the bank £156,554. The liquidators collected book debts to the value of £113,484 but refused to account for them to the bank. The bank sought a declaration that the debenture created a fixed charge over the company's book debts and the proceeds thereof and an order that the liquidators account to the bank in respect of them. The judge, declining to follow a Court of Appeal authority which had been disapproved by the Privy Council, refused the relief sought on the ground that the charge over the book debts granted by the company to the bank was a floating charge and therefore did not have priority over the claims of preferential creditors. The Court of Appeal allowed the bank's appeal and held, inter alia, that the charge over the book debts was a fixed charge which gave the bank priority over the claims of preferential creditors.

On appeal by the Revenue and Customs Commissioners and the Secretary of State for Trade and Industry as Crown creditors

Held, allowing the appeal, (1) that under a fixed charge the assets charged as security were permanently appropriated to the payment of the sum charged in such a way as to give the chargee a proprietary interest in the assets and to impose restrictions on the chargor's use of the asset; that, by contrast, the essential characteristic of a floating charge was that the asset subject to the charge was not finally appropriated as a security for the payment of the debt until the occurrence of some future event, and in the meantime the chargor was free to use the charged asset and remove it from the security; that the restrictions on the company's right to deal *682 with uncollected book debts did not enable the bank to realise its security over those uncollected book debts, or to sell the book debts without first taking some steps following what would amount to a crystallisation event; that, although the company was prevented from entering into transactions with any third party in relation to book debts prior to their collection, once the book debts had been collected and paid into the company's current account, the bank's debenture placed no restriction on the use that the company could make of the balance on the account; that since it was not a blocked account the company could continue to draw on it, and the bank was contractually obliged to honour the company's cheques; that therefore the charge over the company's book debts had the characteristics of a floating charge; and that, accordingly, the debenture, although expressed to grant the bank a fixed charge, in law granted only a floating charge which did not have priority over the claims of preferential creditors (post, paras 1, 44, 53, 55-64, 75, 110-120, 128, 129, 138-139, 152-155, 162, 164-165).

Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142 and *In re New Bullas Trading Ltd [1994] 1 BCLC 485, CA overruled* .

Agnew v Comr of Inland Revenue [2001] 2 AC 710, PC approved .

(2) That the established practice of judicial precedent derived from the common law, and constitutionally judges had power to modify that practice; that there was a flexibility inherent in this country's legal system and there could be circumstances where prospective overruling would be necessary to serve the underlying objective of the courts, which was to administer justice fairly and in accordance with the law; that there could be cases where a decision on an issue of law was unavoidable but the decision would have such gravely unfair and disruptive consequences for past transactions or happenings that the House of Lords would be compelled to depart from the normal principles relating to the retrospective and prospective effect of court decisions; that if, altogether exceptionally, their Lordships as the country's supreme court were to follow that course and overrule a case with prospective effect only, it would not be trespassing outside the functions properly to be discharged by the judiciary; that (Lord Steyn and Lord Scott of Foscote dissenting) even in respect of an issue of statute law it could not be said that prospective overruling could never be justified as a proper exercise of judicial power; and that, therefore, it was not necessarily and always beyond the competence of the House of Lords ever to limit the temporal effect of its ruling (post, paras 16, 39-41, 45, 71-74, 125-126, 129, 161-162, 165).

(3) That the present case did not fall into that exceptional category of case in which alone a prospective overruling would be legitimate; that although their Lordships had overruled a long-standing decision which had for many years been relied on when formulating and using standard forms of charges on book debts, banks and other commercial lenders were sophisticated operators who could not have been lulled into a false sense of security by what was a first instance decision, so that it could not have been regarded as finally and definitively settling the law; that if the firm and unanimous decision of their Lordships were given prospective effect only it would result in preferential creditors in many existing liquidations being deprived of the priority, which, on a correct view of the law, Parliament intended they should have; that (per Lord Scott of Foscote) to deprive preferential creditors of the rights given to them by statute would be to suspend a law that Parliament had enacted, and that would be contrary to the spirit and, perhaps, the letter of the Bill of Rights; and that, accordingly, the decision should take effect without any temporal restriction (post, paras 43, 46, 74, 122, 127, 129, 161, 162, 164, 165).

Decision of the Court of Appeal [2004] EWCA Civ 670; [2004] Ch 337; [2004] 3 WLR 503; [2004] 4 All ER 995 reversed .

Decision of Sir Andrew Morritt V-C [2004] EWHC 9 (Ch); [2004] Ch 337; [2004] 2 WLR 783; [2004] 1 All ER 981 restored .

The following cases are referred to in the opinions of their Lordships:

Agnew v Comr of Inland Revenue [2000] 1 NZLR 223; [2001] UKPC 28; [2001] 2 AC 710; [2001] 3 WLR 454, PC Attorney General for Jersey v Holley [2005] UKPC 23; [2005] 2 AC 580; [2005] 3 WLR 29, PC

Banca Popolare di Cremona v Agenzia Entrate Ufficio Cremona (Case C-475/03) (unreported) 17 March 2005, Advocate General
Bank of Credit and Commerce International SA (No 8), In re [1998] AC 214; [1997] 3 WLR 909; [1997] 4 All ER 568, HL(E)
Barclays Bank plc v O'Brien [1994] 1 AC 180; [1993] 3 WLR 786; [1993] 4 All ER 417, HL(E)
Beam (James B) Distilling Co v Georgia (1991) 501 US 529
Benedict v Ratner (1925) 268 US 353
Bingham v Miller (1848) 17 Ohio 455
Brightlife Ltd, In re [1987] Ch 200; [1987] 2 WLR 197; [1986] 3 All ER 673
Carse v Coppen 1951 SC 233
Chevron Oil Co v Huson (1971) 404 US 97
Colonial Trusts Corpn, In re; Ex p Bradshaw (1879) 15 Ch D 465
Company (No 005009 of 1987), In re A; Ex p Copp [1989] BCLC 13
Cosslett (Contractors) Ltd, In re [1998] Ch 495; [1998] 2 WLR 131; [1997] 4 All ER 115, CA
Davis v Johnson [1979] AC 264; [1978] 2 WLR 553; [1978] 1 All ER 1132, HL(E)
Defrenne v Sabena (Case 43/75) [1976] ICR 547; [1976] ECR 455; [1981] 1 All ER 122n, ECJ
Donoghue v Stevenson [1932] AC 562, HL(Sc)
Edward and Edward, In re (1987) 39 DLR (4th) 654
Evans v Rival Granite Quarries Ltd [1910] 2 KB 979, CA
Fitzpatrick v Sterling Housing Association Ltd [2001] 1 AC 27; [1999] 3 WLR 1113; [1999] 4 All ER 705, HL(E)
Florence Land and Public Works Co, In re; Ex p Moor (1878) 10 Ch D 530, CA
Glazner v Glazner (2003) 347 F 3d 1212
Golak Nath v State of Punjab (1967) 2 SCR 762
Goodwin v United Kingdom (2002) 35 EHRR 447
Great Northern Railway Co v Sunburst Oil and Refining Co (1932) 287 US 358
Griffith v Kentucky (1987) 479 US 314
Ha v State of New South Wales (1997) 189 CLR 465
Halesowen Presswork and Assemblies Ltd v National Westminster Bank Ltd [1971] 1 QB 1; [1970] 3 WLR 625; [1970] 3 All ER 473, CA ; [1972] AC 785; [1972] 2 WLR 455; [1972] 1 All ER 641, HL(E)
Hall (Arthur J S) & Co v Simons [2002] 1 AC 615; [2000] 3 WLR 543; [2000] 3 All ER 673, HL(E)
Harper v Virginia Department of Taxation (1993) 509 US 86
Hart v Barnes (1982) 7 ACLR 310
Hindcastle Ltd v Barbara Attenborough Associates Ltd [1997] AC 70; [1996] 2 WLR 262; [1996] 1 All ER 737, HL(E)
Holidair Ltd, In re [1994] 1 ILRM 481
Holroyd v Marshall (1862) 10 HL Cas 191, HL(E)
Hoverd Industries Ltd v Supercool Refrigeration and Air Conditioning (1991) Ltd [1994] 3 NZLR 300; [1995] 3 NZLR 577
India Cement Ltd v State of Tamil Nadu (1990) 1 SCC 12
Keenan Bros Ltd, In re [1986] BCLC 242
Kleinwort Benson Ltd v Lincoln City Council [1999] 2 AC 349; [1998] 3 WLR 1095; [1998] 4 All ER 513, HL(E)
Language Rights under the Manitoba Act 1870, Reference re (1985) 19 DLR (4th) 1
*Launchbury v Morgans [1973] AC 127; [1972] 2 WLR 1217; [1972] 2 All ER 605, HL(E) *683*
Linkletter v Walker (1965) 381 US 618
Lipkin Gorman v Karpnale Ltd [1989] 1 WLR 1340; [1992] 4 All ER 409, CA
Marckx v Belgium (1979) 2 EHRR 330
Miliangos v George Frank (Textiles) Ltd [1976] AC 443; [1975] 3 WLR 758; [1975] 3 All ER 801, HL(E)
Moor v Anglo-Italian Bank (1879) 10 Ch D 681
Murphy v Attorney General [1982] IR 241
New Bullas Trading Ltd, In re [1993] BCLC 1389 ; [1994] 1 BCLC 485, CA
Orissa Cement Ltd v State of Orissa (1991) 2 SCR 105
Panama, New Zealand and Australian Royal Mail Co, In re (1870) LR 5 Ch App 318
Portbase Clothing Ltd, In re [1993] Ch 388; [1993] 3 WLR 14; [1993] 3 All ER 829
Practice Statement (Judicial Precedent) [1966] 1 WLR 1234; [1966] 3 All ER 77, HL(E)
R v Bow Street Metropolitan Stipendiary Magistrate, Ex p Pinochet Ugarte [2000] 1 AC 61; [1998] 3 WLR 1456; [1998] 4 All ER 897, HL(E)
R v Bow Street Metropolitan Stipendiary Magistrate, Ex p Pinochet Ugarte (No 2) [2000] 1 AC 119; [1999] 2 WLR 272; [1999] 1 All ER 577, HL(E)

R v Governor of Brockhill Prison, Ex p Evans (No 2) [1999] QB 1043; [1999] 2 WLR 103; [1998] 4 All ER 993, CA ; [2001] 2 AC 19; [2000] 3 WLR 843; [2000] 4 All ER 15, HL(E)
R v National Insurance Comr, Ex p Hudson [1972] AC 944; [1972] 2 WLR 210; [1972] 1 All ER 145, HL(E)
R (Bidar) v Ealing London Borough Council (Case C-209/03) [2005] QB 812; [2005] 2 WLR 1078; [2005] All ER (EC) 687, ECJ
Rondel v Worsley [1969] 1 AC 191; [1967] 3 WLR 1666; [1967] 3 All ER 993, HL(E)
Royal Bank of Scotland v Etridge plc (No 2) [2001] UKHL 44; [2002] 2 AC 773; [2001] 3 WLR 1021; [2001] 4 All ER 449, HL(E)
Salomon v A Salomon & Co Ltd [1897] AC 22, HL(E)
Sharp v Thomson 1997 SC (HL) 66
Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142
Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council [2001] UKHL 58; [2002] 1 AC 336; [2001] 3 WLR 1347; [2002] 1 All ER 292, HL(E)
Street v Mountford [1985] AC 809; [1985] 2 WLR 877; [1985] 2 All ER 289, HL(E)
Tailby v Official Receiver (1888) 13 App Cas 523, HL(E)
Welsh Development Agency v Export Finance Co [1992] BCLC 148, CA
West Midland Baptist (Trust) Association Inc v Birmingham Corpn [1970] AC 874; [1969] 3 WLR 389; [1969] 3 All ER 172, HL(E)
Westminster Bank Ltd v Hilton (1926) 43 TLR 124, HL(E)
William Gaskell Group Ltd v Highley [1994] 1 BCLC 197
Wilson v First County Trust Ltd (No 2) [2003] UKHL 40; [2004] 1 AC 816; [2003] 3 WLR 568; [2003] 4 All ER 97, HL(E)
Worcester Works Finance Ltd v Cooden Engineering Co Ltd [1972] 1 QB 210; [1971] 3 WLR 661; [1971] 3 All ER 708, CA
Yorkshire Woolcombers Association Ltd, In re [1903] 2 Ch 284, Farwell J and CA ; sub nom *Illingworth v Houldsworth* [1904] AC 355, HL(E)
Young v Bristol Aeroplane Co Ltd [1944] KB 718; [1944] 2 All ER 293, CA

The following additional cases were cited in argument:

Atlantic Computer Systems plc, In re [1992] Ch 505; [1992] 2 WLR 367; [1992] 1 All ER 476, CA
Barclays Bank plc v Willowbrook International Ltd [1987] 1 FTLR 386, CA
Bourne v Keane [1919] AC 815, HL(E)
Cimex Tissues Ltd, In re [1994] BCC 626
Governments Stock and other Securities Investment Co Ltd v Manila Railway Co Ltd [1897] AC 81, HL(E) *684
Hamilton's Windsor Ironworks, In re Ex p Pitman & Edwards (1879) 12 Ch D 707
Polly Peck International plc, In re [1996] BCC 486
Reynoldsville Casket Co v Hyde (1995) 514 US 749

APPEAL from the Court of Appeal

By permission of the Court of Appeal (Lord Phillips of Worth Matravers MR, Jonathan Parker and Jacob LJ), the Revenue and Customs Commissioners and the Secretary of State for Trade and Industry, as parties subrogated to the preferential creditors, appealed from that court's decision on 26 May 2004, allowing the appeal of National Westminster Bank plc from a decision of Sir Andrew Morritt V-C, who on 15 January 2004 had dismissed the bank's application for (1) a declaration that a debenture that the bank had entered into with Spectrum Plus Ltd ("the company") to secure moneys advanced by way of an overdraft on a current account created a fixed charge over the company's book debts and the proceeds of the company's book debts; and (2) an order that Richard Hawes and David Thomas, liquidators of the company, account to the bank for the full amount of book debt realisations being withheld by them.

The facts are stated in the opinions of their Lordships.

Michael Briggs QC, Philip Jones and Catherine Addy for the commissioners. An intelligible test for the identification of a floating charge was first formulated by Romer LJ in *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 , 295 and approved (*sub nom Illingworth v Houldsworth* [1904] AC 355) by the House of Lords. The purpose of the test is in one sense directed to whether there is a floating charge, but essentially it relates to what a fixed charge is.

That test was misapplied in *Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142* where the facts are indistinguishable from the present case. The question of construction on these facts is whether Spectrum could use its book debts as a source of cash flow without the bank's consent.

The first and second of the three criteria formulated by Romer LJ in the *Yorkshire Woolcombers* case are satisfied in the present case. The question therefore is whether the third criterion was satisfied, namely, whether by the charge it was contemplated that, until some future step was taken by the bank, Spectrum could carry on its business in the ordinary way as far as book debts were concerned. The answer must plainly be in the affirmative. Far from preventing Spectrum from dealing with its book debts in the ordinary course of its business pending demand by the bank, the debenture positively compelled Spectrum to do so. A charge which leaves the chargor free to use the asset cannot be a fixed charge.

However superficially attractive the ruling in the *Siebe Gorman* case might be from the point of view of simplicity, its effect is in substance wholly to subvert Romer LJ's third criterion because it permits companies and their lenders to construct a formal regime for exploitation of book debts designed for the specific purpose of enabling the company to carry on its business in the ordinary way, under the security of a fixed charge, and thereby to circumvent the statutory consequences of a floating security.

The Court of Appeal felt obliged to follow the decision in *In re New Bullas Trading Ltd [1994] 1 BCLC 485*, which was held to be wrongly ***685** decided by the Privy Council in *Agnew v Comr of Inland Revenue [2001] 2 AC 710* and should therefore be overruled in order to avoid the unsatisfactory consequences of courts in this jurisdiction being bound by the Court of Appeal's decision notwithstanding a Privy Council decision that it was wrong.

The Court of Appeal also erred in their view that it would be wrong to overrule the *Siebe Gorman* case because it had been relied on by banks in their dealings with corporate customers for many years. Since Parliament has imposed specific consequences upon the use of floating charges in the interest of persons other than the chargor and chargee, it is not for the court to convert what is truly a floating charge into a fixed charge because of a customary assumption to that effect made by banks and their corporate customers. If a charge over an asset which leaves the chargor free to use its proceeds in the ordinary course of its business is incapable of being a fixed charge, then banks would in any event have taken the limited adverse statutory consequences over the last 20 years rather than discontinue a widespread and lucrative activity.

Although it is accepted that banks will have relied on the *Siebe Gorman* case in formulating their standard form securities when granting lending facilities to companies, the submission that to overrule that case would be unfair to banks carries no weight unless either the banks could have used some other commercially inconsequential drafting device to produce a fixed charge over book debts or, absent a fixed charge, banks would have lent less on an overdraft.

There is no drafting device which can convert what is in substance a floating charge into a fixed charge. Prudent banks lend what they think will be repaid and not what they expect to recover upon the enforcement of their security. Where there is an agreed overdraft limit on a current account, the banker is under a legal obligation to honour a cheque which is presented for payment by a third party and which can be met without the overdraft limit being exceeded. It is not a matter for the banker's discretion. As a matter of general banking law the banker does not have a lien over any credit balances for payment of debit balances on other accounts or other liabilities owed by the customer to the banker: see *Halesowen Presswork and Assemblies Ltd v National Westminster Bank Ltd [1971] 1 QB 1*. The benefits obtained by the banks from the *Siebe Gorman* decision have been a windfall.

The only custom or usage which can have arisen from the tendency of banks to use the *Siebe Gorman* form of charge on the assumption that it created a fixed charge was a custom that flew in the face of reality and produced a result directly contrary to statutory provision which has now been in place for over a century. To permit a commercially inconsequential drafting device to convert what was by its nature a floating charge into a fixed charge would deprive preferential creditors of the protection afforded to them by Parliament. [Reference was made to *In re Panama, New Zealand and Australian Royal Mail Co (1870) LR 5 Ch App 318*; *In re Florence Land and Public Works Co, Ex p Moor (1878) 10 Ch D 530*; *In re Hamilton's Windsor Ironworks, Ex p Pitman & Edwards (1879) 12 Ch D 707*; *In re Colonial Trusts Corpn, Ex p Bradshaw (1879) 15 Ch D 465*; *Governments Stock and other Securities Investment Co Ltd v Manila Railway Co Ltd [1897] AC 81*; *Salomon v A Salomon & Co Ltd [1897] AC 22*; *Evans v Rival Granite Quarries Ltd [1910] 2 KB 979*; *In re Keenan Bros Ltd [1986] BCLC 242*; ***686** *In re Brightlife Ltd [1987] Ch 200*; *In re A Company (No 005009), Ex p Copp [1989] BCLC 13*; *Hoverd Industries Ltd v Supercool Refrigeration and Air Conditioning (1991) Ltd [1994] 3 NZLR 300*; *In re Atlantic Computer Systems plc [1992] Ch 505* and *William Gaskell Group Ltd v Highley [1994] 1 BCLC 197*.]

The principle is that if a court comes to the view that an earlier decision is clearly wrong and its perpetuation causes injustice the decision ought to be overruled: see *Bourne v Keane* [1919] AC 815 . Injustice would be caused by not overruling *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 . It has caused injustice in the past although there has been no protest by the victims of that injustice. The injustice would be perpetuated if it is not overruled. Guarantors would be aware of the essential fragility of a first instance decision even if they rely on it. After the decision in the *Agnew* case it would have been obvious that the *Siebe Gorman* case was at risk and would have to be looked at again. Liquidators would have been aware of that and held up distributions.

If the *Siebe Gorman* decision is wrong it is for the courts and not Parliament to correct it. The House of Lords may have power to overrule previous decisions with prospective effect only, although that power has never been exercised. The following principles ought to form part of any criteria for the exercise of the power.

First, the exercise of the power must always be the exception from the normal retrospective effect of the overruling of an earlier decision. In no jurisdiction is it the norm. Special circumstances will always have to be shown above and beyond those normally arising from an overruling if the exercise of the power is to be justified in any particular case.

Secondly, a necessary but by no means sufficient condition for the exercise of the power must be that there has been reliance upon the decision overruled which would be detrimental if overruling was to have retrospective effect. The central justification for the exercise of the power is that it removes or alleviates what would otherwise be the injustice caused by retrospective overruling to those who have conducted their affairs on the understanding that the law was as previously stated in the decision overruled.

Thirdly, the overruling must in substance change previously settled law. That plainly occurs where the House of Lords departs from one of its previous decisions. The same may usually, but not always, be the case where a previous decision of the Court of Appeal is overruled by the House of Lords.

Fourthly, the power should not be exercised if to do so would conflict with the perceived will of Parliament expressed in legislation. If the conclusion was that the decision overruled had during its currency as precedent failed to apply or frustrated a statutory provision, it ought to be overruled with full retrospective effect.

Finally, the potential injustice of a retrospective overruling to those relying on the earlier decision cannot be viewed in isolation. In most cases the decision to overrule will be because the earlier decision was itself unjust, and that injustice would not normally be cured by a merely prospective overruling.

The present case is not an appropriate one for prospective overruling. The statutory regime for the postponement of floating charges to ^{*687} preferential debts was instituted by Parliament for the benefit of classes of persons distinct from the parties to the charges in issue.

The retrospective overruling of the *Siebe Gorman* case will give effect to the will of Parliament whereas a merely prospective overruling will not, otherwise than in the future. Retrospective overruling will also put right the injustice to preferential creditors of being deprived of the priority which Parliament intended to afford them.

Gabriel Moss QC and *Jeremy Goldring* for the bank. The *Siebe Gorman* decision is important in that it established that it was possible to create a fixed charge over circulating assets such as book debts. No doubt has been cast on that case in the English courts. As a consequence it has been relied on by banks, liquidators and receivers as correctly representing the law. [Reference was made to *Barclays Bank plc v Willowbrook International Ltd* [1987] 1 FTLR 386 ; *In re Polly Peck International plc* [1996] BCC 486 ; *Welsh Development Agency v Export Finance Co* [1992] BCLC 148 ; *In re Brightlife Ltd* [1987] Ch 200 ; *In re Cimex Tissues Ltd* [1994] BCC 626 and *Tailby v Official Receiver* (1888) 13 App Cas 523 .]

Even if the *Siebe Gorman* case was wrongly decided it would not follow that, properly construed, the debenture in the present case contained no restriction on Spectrum's ability to use any credit balance in its account. The principle of construction is that contracts should be construed in the context of the legal background against which they were entered into.

The application of that principle leads to the conclusion that, even if the debenture in the *Siebe Gorman* case, on its true construction failed to confer any power on the bank to prevent the customer drawing on the account, it does not follow that the debenture in the present case likewise failed to do so. When the parties in the present case came to execute the debenture it was established that a debenture in the *Siebe Gorman* form imposed a restriction on the customer's dealings with his current account

even when it was in credit. In selecting a debenture in that form the parties are taken to have contracted against that background and to have agreed both as to the express terms of the debenture and the legal baggage that it carried, including its true meaning as interpreted by the courts. Accordingly, on a true construction of a debenture executed in 1997 rather than before 1979, there was a contractual restriction on Spectrum's ability to draw on the account, even when it was in credit.

Commercial certainty requires that the *Siebe Gorman* case be followed even if the House of Lords would not necessarily have decided it the same way. Where a judicial decision has established the meaning and effect of a particular document or otherwise established principles forming the basis of contracts or affecting the general conduct of affairs, and their alteration would mean that payments have been needlessly made, the meaning should not be altered unless the judicial decision was both clearly wrong and productive of serious inconvenience and injustice. The decision in *Siebe Gorman*, even if it is considered to have been wrongly decided, should not be overruled because it is an established decision which has caused neither serious inconvenience nor injustice. Despite numerous amendments to the law of insolvency since the decision in *Siebe Gorman* Parliament has not intervened to reverse it. The consequence of altering the law by not following that decision would be to undermine title to property and the *688 effect of numerous commercial contracts. Any change in the law is now properly a matter for Parliament. Legislation would take effect only from the moment when it became law and could be tailored to deal with the unjust consequences that would arise. If the *Siebe Gorman* decision is to be overruled, it should be done prospectively so that transactions entered into before the date of overruling are dealt with on the basis that it was correctly decided.

The existence of a power in the House of Lords to overrule with prospective effect only is justifiable as a matter of legal theory and desirable in practice. The declaratory theory of judicial decisions is no longer accepted in traditional form. Once the reality is accepted that judges make the law within their proper sphere there is no theoretical reason why the House of Lords should not overrule with prospective effect only. It is among the functions of the House of Lords to provide coherent and principled development of the law. However, if decisions of the House of Lords are without exception retrospective in effect, the House may be faced with the choice of betraying expectations created by previous judicial precedent or following, and so reinforcing, a decision that it considers to be plainly wrong. Prospective overruling provides a means whereby those alternatives can be reconciled. The House can both give weight to the reliance placed on previous judicial precedent in the past and at the same time rectify or develop the law for the future. Prospective overruling is not inconsistent with stare decisis and supports rather than undermines it. Prospective overruling in other jurisdictions, including common law jurisdictions, confirms that it is a useful practice.

Prospective overruling is appropriate in the present case. The law of corporate security generally is one in which such a technique is particularly important because serious uncertainty can be caused by a single judicial decision. That applies with particular force in the present case. If the overruling were to be retrospective it would have inequitable results which would affect several legal relationships.

Ian Glick QC and *Edmund Nourse* as amici curiae. There can be no doubt that the House of Lords has power or jurisdiction to alter its own practice, and that of the courts below it, prospectively. It did so in relation to the binding effect of its own former decisions: see *Practice Statement (Judicial Precedent)* [1966] 1 WLR 1234 .

There are four, to some extent overlapping, arguments why the House of Lords cannot and should not overrule or change substantive law with prospective effect only, save where authorised by statute to do so. First, the existence of such a jurisdiction or the power to assume such a jurisdiction is inconsistent with the reasoning in *Kleinwort Benson Ltd v Lincoln City Council* [1992] 2 AC 349 . Secondly, prospective overruling is contrary to the common law's declaratory theory of judicial decisions. Thirdly, prospective overruling is not a judicial process. And fourthly, without statutory authorisation, such a jurisdiction would be unconstitutional in relation to the construction of a statute.

Only two common law jurisdictions have without legislation espoused prospective overruling: the United States of America and India. Although prospective overruling may be used at state court level in the USA, it appears to have been virtually abandoned by the United States Supreme Court itself. *689 The European Court of Justice declares the law in that it declares what European statutes mean since they were enacted. [Reference was made to the Advocate General's opinion in *Banca Popolare di Cremona v Agenzia Entrate Ufficio Cremona* (Case C-475/03) (unreported) 17 March 2005 and *R (Bidar) v Ealing London Borough Council* (Case C-209/03 [2005] QB 812 .]

The principal justification for assuming a jurisdiction to overrule prospectively is that the retrospective effect of overruling can be to disturb transactions carried out, and expectations formed, while the old view of the law prevailed. Prospective overruling causes the greatest problems in criminal law due to the uncertainty of its effect [Reference was made to *Griffith v Kentucky*

(1987) 479 US 314 ; *Harper v Virginia Department of Taxation* (1993) 509 US 86 and *Reynoldsville Casket Co v Hyde* (1995) 514 US 749 .]

Overruling prospectively is another species of not overruling at all. The issue is whether the House of Lords has jurisdiction to nullify what would otherwise be the effect of overruling.

Moss QC replied.

Briggs QC also replied.

Their Lordships took time for consideration. 30 June.

LORD NICHOLLS OF BIRKENHEAD

1. My Lords, I have had the advantage of reading in draft the opinions of my noble and learned friends, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give I agree that the decision of Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 was wrong and should be overruled.

2. The respondent bank had a second string to its bow. The bank contended that if the House considered *Siebe Gorman* was wrongly decided the House should overrule that decision only for the future. The bank submitted that the *Siebe Gorman* decision should continue to apply to all transactions entered into before your Lordships' decision in the present case, including the debenture under consideration on this appeal.

3. This submission raises a controversial issue of major importance concerning the power of your Lordships' House to give a ruling in this "prospective only" form. The bank argued the House has this power. The Crown appellants were content to assume the House may have this power. At very short notice the Attorney General, on the invitation of your Lordships, appointed Mr Glick to assist the House by presenting the case against the House having any such jurisdiction. The House is indebted to Mr Glick, who was assisted by Mr Edmund Nourse, for his clear and comprehensive presentation of this case.

Prospective overruling

4. The starting point is to note some basic, indeed elementary, features of this country's judicial system. The first concerns the essential role of courts of law. In the ordinary course the function of a court is adjudicative. Courts decide the legal consequences of past happenings. Courts make findings on disputed questions of fact, identify and apply the relevant law to the facts *690 agreed by the parties or found by the court, and award appropriate remedies.

5. The second feature concerns the wider effect of a court decision on a point of law. To promote a desirable degree of consistency and certainty about the present state of "the law", courts in this country have long adopted the practice of treating decisions on a point of law as precedents for the future. If the same point of law arises in another case at a later date a court will treat a previous decision as binding or persuasive, depending upon the well-known hierarchical principles of "stare decisis".

6. The third feature is that from time to time court decisions on points of law represent a change in what until then the law in question was generally thought to be. This happens most obviously when a court departs from, or an appellate court overrules, a previous decision on the same point of law. The point of law may concern the interpretation of a statute or it may relate to a principle of "judge-made" law, that is, the common law (which for this purpose includes equity). A change of this nature does not always involve departing from or overruling a previous court decision. Sometimes a court may give a statute, until then free from judicial interpretation, a different meaning from that commonly held.

7. The fourth feature is a consequence of the second and third features. A court ruling which changes the law from what it was previously thought to be operates retrospectively as well as prospectively. The ruling will have a retrospective effect so far as the parties to the particular dispute are concerned, as occurred with the manufacturer of the ginger beer in *Donoghue v Stevenson* [1932] AC 562 . When Mr Stevenson manufactured and bottled and sold his ginger beer the law on manufacturers' liability as generally understood may have been as stated by the majority of the Second Division of the Court of Session and the minority of their Lordships in that case. But in the claim Mrs Donoghue brought against Mr Stevenson his legal obligations fell to be decided in accordance with Lord Atkin's famous statements. Further, because of the doctrine of precedent the same would be true of everyone else whose case thereafter came before a court. Their rights and obligations would be decided according

to the law as enunciated by the majority of the House of Lords in that case even though the relevant events occurred before that decision was given.

8. People generally conduct their affairs on the basis of what they understand the law to be. This "retrospective" effect of a change in the law of this nature can therefore have disruptive and seemingly unfair consequences. "Prospective overruling", sometimes described as "non-retroactive overruling", is a judicial tool fashioned to mitigate these adverse consequences. It is a shorthand description for court rulings on points of law which, to greater or lesser extent, are designed not to have the normal retrospective effect of judicial decisions.

9. Prospective overruling takes several different forms. In its simplest form prospective overruling involves a court giving a ruling of the character sought by the bank in the present case. Prospective overruling of this simple or "pure" type has the effect that the court ruling has an exclusively prospective effect. The ruling applies only to transactions or happenings occurring after the date of the court decision. All transactions entered into, or events occurring, before that date continue to be governed by the law as it was conceived to be before the court gave its ruling.

***691**

10. Other forms of prospective overruling are more limited and "selective" in their departure from the normal effect of court decisions. The ruling in its operation may be prospective and, additionally, retrospective in its effect as between the parties to the case in which the ruling is given. Or the ruling may be prospective and, additionally, retrospective as between the parties in the case in which the ruling was given and also as between the parties in any other cases already pending before the courts. There are other variations on the same theme.

11. Recently Advocate General Jacobs suggested an even more radical form of prospective overruling. He suggested that the retrospective *and prospective* effect of a ruling of the European Court of Justice might be subject to a temporal limitation that the ruling should not take effect until a future date, namely, when the State had had a reasonable opportunity to introduce new legislation: *Banca Popolare di Cremona v Agenzia Entrate Ufficio Cremona (Case C-475/03) (unreported) 17 March 2005*, paras 72-88.

United Kingdom practice

12. Prospective overruling has not yet been adopted as a practice in this country. The traditional approach was stated crisply by Lord Reid in *West Midland Baptist (Trust) Association Inc v Birmingham Corpn [1970] AC 874*, 898-899, a case concerning compulsory acquisition:

"We cannot say that the law was one thing yesterday but is to be something different tomorrow. If we decide that [the existing rule] is wrong we must decide that it always has been wrong, and that would mean that in many completed transactions owners have received too little compensation. But that often happens when an existing decision is reversed."

13. In *Launchbury v Morgans [1973] AC 127*, 137, Lord Wilberforce noted "We cannot, without yet further innovation, change the law prospectively only". More recently, in *Kleinwort Benson Ltd v Lincoln City Council [1992] 2 AC 349*, 379, Lord Goff of Chieveley said the system of prospective overruling "has no place in our legal system".

14. The possibility of a change in this practice has been raised from time to time. In *R v National Insurance Comr, Ex p Hudson [1972] AC 944*, 1015, 1026, Lord Diplock said this topic deserved consideration. Lord Simon of Glaisdale said the possibility of prospective overruling should be seriously considered. He expressed a preference for legislation, saying that "informed professional opinion" was probably to the effect that the House had no power to overrule decisions with prospective effect only. Lord Simon repeated his plea in *Miliangos v George Frank (Textiles) Ltd [1976] AC 443*, 490. In the Court of Appeal in *R v Governor of Brockhill Prison, Ex p Evans (No 2) [1999] QB 1043*, 1058, Lord Woolf MR expressed the view that prospective overruling has much to commend it. In your Lordships' House this issue was left open: [2001] 2 AC 19. Lord Slynn of Hadley, with his Luxembourg experience in mind, considered there may be situations in which it would be desirable, and in no way unjust, that the effect of judicial rulings should be prospective or limited to certain claimants: p 26. Lord Hobhouse of Woodborough was hostile to prospective overruling, describing it as a denial of the constitutional role of the courts: p 48. In the ***692** advocates' immunity case of *Arthur JS Hall & Co v Simons [2002] 1 AC 615* the House departed from the earlier decision of the House in *Rondel v Worsley [1969] 1 AC 191*. The decision on the immunity point in the *Hall* case did not affect the actual

outcome in that case. In that context my noble and learned friend Lord Hope of Craighead expressed the view that the change in the law made by the *Hall* decision should take effect only from the date of the judgment in that case: p 726. He said, at p 710:

"I consider it to be a legitimate exercise of your Lordships' judicial function to declare prospectively whether or not the immunity—which is a judge-made rule—is to be available in the future and, if so, in what circumstances."

15. Perhaps the nearest the House has come to giving non-retroactive rulings was in two decisions on the law of undue influence. The decisions concerned cases where, typically, a wife claims her consent to a mortgage of her share in a jointly-owned home was procured by her husband exercising undue influence over her: *Barclays Bank plc v O'Brien* [1994] 1 AC 180 and *Royal Bank of Scotland plc v Etridge (No 2)* [2002] 2 AC 773. In both cases the House said that, in order to avoid being fixed with constructive notice of the wife's rights, a bank could reasonably be expected to bring home to the wife the risks she was running. But in both cases the House sought to give guidance by being more specific on what that test meant in practice. It was in this limited respect that in both cases the House, having regard to realities, drew a distinction between past and future transactions. In the *O'Brien* case, at pp 196-197, Lord Browne-Wilkinson said that whether the steps taken by the creditor satisfied the prescribed test would, for past transactions, depend on the facts of each case. As to the future, an appropriately worded warning given at a private meeting between the creditor and the wife would generally suffice to satisfy the test. Despite this admonition the banks did not adopt the course of holding such a meeting. In the *Etridge* case the House decided that holding a private meeting was not the only way a bank could discharge its obligation to bring home to the wife the risks she was running. I set out, at pp 811-812, paras 79-80, other steps which would generally be regarded as discharging this obligation as to future transactions and, separately, as to past transactions.

16. These two decisions illustrate the flexibility inherent in this country's legal system. In passing, another instance of this flexibility can be noted. This illustrates how the House has been prepared to depart from a strict and narrow interpretation of the judiciary's adjudicative role. From time to time situations occur where a point of law of general importance is raised by court proceedings but the outcome will have no practical effect in the particular case. The general principle is that the court will not entertain such proceedings. Nevertheless, when there is good reason for doing so, the House, in the cautious exercise of its discretion, may proceed to decide the point of law. A recent example occurred in the Judicial Committee of the Privy Council in *Attorney General for Jersey v Holley* [2005] 2 AC 580 . There an enlarged Board resolved a conflict between previous decisions of the Board and the House of Lords on an important issue concerning the defence of provocation to a charge of murder. The Board decided this point even though the outcome, either way, would have no effect on the conviction or sentence of the defendant in that case.

*693

17. One further matter may be noted regarding the present position on prospective overruling. In the devolution legislation of 1998 Parliament made express provision for courts to have power to limit the temporal effect of a particular class of decisions. The *Scotland Act 1998, section 102* , provides that where a court decides a provision in an Act of the Scottish Parliament is not within the legislative competence of the Parliament the court may make an order removing or limiting any retrospective effect of the decision or suspending the effect of the decision to enable the defect to be corrected. Comparable provisions appear in the *Government of Wales Act 1998, section 110* , and the *Northern Ireland Act 1998, section 81* . These provisions show that Parliament does not perceive non-retroactive rulings by courts as being of their nature inconsistent with the judiciary's proper function.

Overseas experience

18. In other common law countries prospective overruling has taken root as such only in the United States of America and India. In the United States the fortunes of prospective overruling, sometimes known colloquially as "sunbursting", have waxed and waned. Prospective overruling, although without that label, occurred as long ago as the mid-19th century in the Ohio case of *Bingham v Miller* (1848) 17 Ohio 445 . In 1932 the Supreme Court, in a famous judgment of Cardozo J, held that the Constitution neither prohibits nor requires prospective overruling. The Federal Court, he said, "has no voice upon the subject": see *Great Northern Railway Co v Sunburst Oil and Refining Co* (1932) 287 US 358 . Prospective overruling by the Supreme Court itself reached its apogee in the 1960s and 1970s when the court decided that in both criminal and civil cases "the accepted rule today is that in appropriate cases the court may in the interests of justice make the rule prospective": *Linkletter v Walker* (1965) 381 US 618 , 628. In 1971 in the leading case of *Chevron Oil Co v Huson* (1971) 404 US 97 , 106-107, the court summarised three factors taken into account when considering if a decision should be applied non-retroactively: whether the decision established

a new principle of law, whether retrospective operation would advance or retard the operation of the new rule, and whether the decision could produce substantial inequitable results if applied retrospectively.

19. Since then the Supreme Court has retreated. In *Griffith v Kentucky* (1987) 479 US 314 the court abandoned prospective overruling when directly reviewing criminal cases. Selective overruling has been abandoned in civil cases: *James B Beam Distilling Co v Georgia* (1991) 501 US 529 and *Harper v Virginia Department of Taxation* (1993) 509 US 86 . Whether the court has abandoned "pure" prospective overruling in civil cases remains to be resolved: see *Glazner v Glazner* (2003) 347 F 3d 1212 , a decision of the Court of Appeals of the Eleventh Circuit.

20. Taking its lead from the United States jurisprudence the Supreme Court of India has made prospective overrulings but only in constitutional cases. The first case was *Golak Nath v State of Punjab* (1967) 2 SCR 762 . In that case the court reversed two earlier decisions of its own in circumstances where meanwhile constitutional amendments had been made, and state laws enacted, on the basis of the court's earlier two decisions. The jurisdiction is not confined to cases where an earlier decision is overruled. Non-retroactive effect may be given to a ruling which decides an issue for the first time: *694 *India Cement Ltd v State of Tamil Nadu* (1990) 1 SCC 12 . The Supreme Court founds its jurisdiction to make rulings of this character on article 142 of the Indian Constitution . This article empowers the Supreme Court to "make such order as is necessary for doing complete justice in any cause or matter pending before it". In exercise of this power it is a "well settled proposition that it is open to the court to grant, mould or restrict relief in a manner most appropriate to the situation before it in such a way as to advance the interests of justice": *Orissa Cement Ltd v State of Orissa* (1991) 2 SCR 105 , 181.

21. In Ireland in *Murphy v Attorney General* [1982] IR 241 the Supreme Court held that certain taxation provisions were unconstitutional and void. The court rejected an argument that it was for the courts to say whether these statutory provisions should be held to be invalid prospectively or with only limited retrospective effect. The provisions were invalid from the date on which they were enacted. However, the court also held that the plaintiffs' restitutionary right to recover amounts paid by way of taxes unconstitutionally imposed began with the first year in which they raised their objections. Further, unless other taxpayers had already made tax recovery claims, only the plaintiffs could maintain a claim pursuant to the court's decision.

22. In Canada prospective overruling has not found favour. In *In re Edward and Edward* (1987) 39 DLR (4th) 654 the Saskatchewan Court of Appeal said prospective overruling would be a "dramatic deviation from the norm in both Canada and England". Bayda CJS, at p 664, said "the most cogent reason for rejecting this technique is the necessity for our courts to maintain their independent, neutral and non-legislative role". He approved comments that prospective overruling "would distort our expectations of the judicial role" and that "confidence may recede at the point where the courts are not seen as adjudicative agencies but as legislators": see *Lord Lloyd of Hampstead* , Introduction to Jurisprudence 4th ed (1979), pp 858-859. But in the extreme circumstances of a *Reference re Language Rights under the Manitoba Act 1870* (1985) 19 DLR (4th) 1 the Supreme Court of Canada declined to give retroactive effect to its decision on the constitutional invalidity of all statutes and regulations of the Province of Manitoba not printed and published in both English and French. A declaration that the unilingual laws of Manitoba were of no effect would have created a legal vacuum with consequent legal chaos. Refusing to take a narrow and literal approach to constitutional interpretation, the court held it could have regard to unwritten postulates such as the principle of the rule of law. Faced with the task of recognising the unconstitutionality of Manitoba's unilingual laws while avoiding a legal vacuum and ensuring the continuity of the rule of law, the court made a ruling which gave deemed temporary validity to all laws rendered invalid by reason of their unilingual defect.

Luxembourg and Strasbourg

23. Far-reaching economic consequences may flow from the retrospective effect of rulings by the European Court of Justice on the interpretation of Community instruments. This has led that court to limit the temporal effect of some of its rulings, from *Defrenne v Sabena* [1976] ICR 547 onwards. Sitting as a Grand Chamber the court recently reiterated *695 its basic approach in *R (Bidar) v Ealing London Borough Council* [2005] QB 812 , para 66:

"the interpretation the Court of Justice gives to a rule of Community law is limited to clarifying and defining the meaning and scope of that rule as it ought to have been understood and applied from the time of its coming into force. It follows that the rule as thus interpreted may, and must, be applied by the courts even to legal relationships arising and established before the judgment ruling on the request for interpretation ..." (Emphasis added.)

But the court noted that "exceptionally" it may limit the temporal effect of a ruling. It has done so only in defined circumstances (para 69):

"The court has taken that step only in quite specific circumstances, where there was a risk of serious economic repercussions owing in particular to the large number of legal relationships entered into in good faith on the basis of rules considered to be validly in force and where it appeared that both individuals and national authorities had been led into adopting practices which did not comply with community legislation by reason of objective, significant uncertainty regarding the implications of community provisions, to which the conduct of other member states or the commission may even have contributed ..."

24. Unlike the European Court of Justice and its role in the interpretation of community instruments, the European Court of Human Rights' interpretative function is not confined to identifying the meaning properly to be given to the [European Convention on Human Rights](#) when the Convention first came into force. The Strasbourg court interprets the Convention in the light of present-day conditions: *Marckx v Belgium* (1979) 2 EHRR 330, 353, para 58. In that case, taking heed of the decision of the European Court of Justice in *Defrenne v Sabena* [1976] ICR 547, the Strasbourg court held that the principle of legal certainty dispensed the Belgian state from re-opening legal acts antedating the delivery of its judgment.

25. A notable instance of this "dynamic and evolutive" approach to interpretation can be found in the successive cases relating to recognition of the rights of transsexual persons, culminating in the decision in *Goodwin v United Kingdom* (2002) 35 EHRR 447. In *Goodwin* the court held that the United Kingdom could "no longer claim" that the matter fell within its margin of appreciation and that the fair balance inherent in the Convention "now" tilted in favour of the applicant: para 93. Running through the court's reasoning is an acceptance that the earlier, contrary decisions of the court remained correct statements of the interpretation and application of the Convention when they were given. Consistently with this the court held that the finding of violation "with the consequences which will ensue for the future" was just satisfaction: para 120.

Practical difficulties

26. As with all controversial subjects prospective overruling attracts arguments both ways. The arguments against prospective overruling are both principled and practical. It will be convenient to note first the major practical difficulties attendant upon prospective overruling. The *696 retrospective nature of a court ruling on a point of law means that the ruling applies in all cases, past as well as future. This is subject only to defences of general application, such as limitation, laches, and res judicata. Whatever its faults the retrospective application of court rulings is straightforward. Prospective overruling creates problems of discrimination. Born out of a laudable wish to mitigate the seeming unfairness of a retrospective change in the law, prospective overruling can beget unfairness of its own.

27. This is most marked in criminal cases, where "pure" prospective overruling would leave a successful defendant languishing in prison. "Selective" prospective overruling avoids this consequence but it could see a successful defendant freed while others in like case stayed in prison. In civil cases "pure" prospective overruling would hinder the development of the law by discouraging claimants from challenging a prevailing view of the law. "Selective" overruling, if only the successful claimant benefits from the change, is likely to mean that persons in like case are treated differently. Further, it would introduce an arbitrary element into the law. The ability to obtain an effective remedy could depend upon which of several challenges reaches the House of Lords first. Even if everyone who had already commenced proceedings was given the benefit of the court ruling there would still be scope for discrimination: there would be discrimination between those who knew they might have a claim and started proceeding post-haste and those, lacking proper advice, who were unaware they might have a claim.

Objections in principle

28. The essence of the principled argument against prospective overruling is that in this country prospective overruling is outside the constitutional limits of the judicial function. It would amount to the judicial usurpation of the legislative function. Power to make rulings having only prospective effect, it is said, is not inherent in the judicial role. A ruling having only prospective effect cannot be characterised as merely a less extensive form of overruling than overruling with both retrospective and prospective effect. Prospective overruling robs a ruling of its essential authenticity as a judicial act. Courts exist to decide the legal consequences of past events. A court decision which takes the form of a "pure" prospective overruling does not decide the dispute between the parties according to what the court declares is the present state of the law. With a ruling of this character

the court gives a binding ruling on a point of law but then does not apply the law as thus declared to the parties to the dispute before the court. The effect of a prospective overruling of this character is that, on the disputed point of law, the court determines the rights and wrongs of the parties in accordance with an answer which it declares is no longer a correct statement of the law. Making such a ruling would not be a proper exercise of judicial power in this country. Making new law in this fashion gives a judge too much the appearance of a legislator. Legislation is a matter for Parliament, not judges.

29. In short, this argument raises this issue: would a decision by this House on a point of law having only prospective effect be so substantial a departure from established judicial procedure that it should be regarded as outside the function discharged by the judiciary under this country's constitution?

*697

30. In answering this question the [Appellate Jurisdiction Act 1876](#) (39 & 40 Vict c 59) provides no assistance. The appellate jurisdiction of the House is formally regulated by this Act. [Section 4](#) provides that appeals shall be brought by petition to the House praying that the order appealed may be reviewed "before Her Majesty the Queen in her Court of Parliament" in order that this court "may determine what of right, and according to the law and custom of this realm, ought to be done in the subject matter of such appeal". When [Part III of the Constitutional Reform Act 2005](#) comes into force the new Supreme Court will have power "to determine any question necessary to be determined for the purposes of doing justice in an appeal to it": [section 40\(5\)](#). These general statements do not point either way on the issue now under consideration.

31. The next point to note is that, broadly stated, the constitutional separation of power between the legislature and the judiciary in this country is that the legislature makes the law, the courts administer the law. Parliament makes new law, by enacting statutes having prospective and varying degrees of retrospective effect: see [Wilson v First County Trust Ltd \(No 2\) \[2004\] 1 AC 816](#), 831-832, para 19. When disputes arise, whether between citizens or between a citizen and the Government, they are to be resolved in accordance with the law, and that is a matter for the judicial arm of the state. In this regard it is for the judiciary to decide what is the law, not the legislature or the executive.

32. This broad generalisation is a good starting point but, like most constitutional generalisations in this country, it calls for qualification. The boundary between making and administering the law is not in all respects quite so clear-cut as this general statement suggests. Contrary to the broad generalisation and within strict bounds, judges themselves have a legitimate law-making function. It is a function they have long exercised. In common law countries much of the basic law is still the common law. The common law is judge-made law. For centuries judges have been charged with the responsibility of keeping this law abreast of current social conditions and expectations. That is still the position. Continuing but limited development of the common law in this fashion is an integral part of the constitutional function of the judiciary. Had the judges not discharged this responsibility the common law would be the same now as it was in the reign of King Henry II. It is because of this that "the common law is a living system of law, reacting to new events and new ideas, and so capable of providing the citizens of this country with a system of practical justice relevant to the times in which they live": see Lord Goff of Chieveley in [Kleinwort Benson Ltd v Lincoln City Council \[1992\] 2 AC 349](#), 377.

33. Changes in the common law made by judges are usually described as "development" of the common law. This is a helpful description, not a misleading euphemism. Judges do not have a free hand to change the common law. Judicial development of the common law comprises the reasoned application of established common law principles, of greater or less generality, in current social conditions. Development of the common law by the judges in any one case is usually marginal. Occasionally it is more far-reaching, as in [Donoghue v Stevenson \[1932\] AC 562](#). In all cases development of the common law, as a response to changed conditions, does not come like a bolt out of a clear sky. Invariably the clouds gather first, often from different quarters, indicating with increasing obviousness what is *698 coming. Cardozo J's colourful summary, in his *The Nature of the Judicial Process* (1921), p 141, merits repetition:

"The judge, even when he is free, is still not wholly free. He is not to innovate at pleasure. He is not a knight-errant, roaming at will in pursuit of his own ideal of beauty or of goodness. He is to draw his inspiration from consecrated principles. He is not to yield to spasmodic sentiment, to vague and unregulated benevolence. He is to exercise a discretion informed by tradition, methodized by analogy, disciplined by system, and subordinated to 'the primordial necessity of order in the social life'."

34. At one time the judicial function of overruling previous common law decisions was sought to be rationalised by the "declaratory" theory. Sir William Blackstone said that "if it be found that the former decision is manifestly absurd or unjust,

it is declared, not that such a sentence was *bad law*, but that it was *not law*": Commentaries on the Laws of England, 1st ed (1765), vol 1, p 70. If "law" is given one of its several possible meanings, this theory is still valid when applied to cases where a previous decision is overruled as wrong when given. Most overruling occurs on this basis. These cases are to be contrasted with cases where the later decision represents a response to changes in social conditions and expectations. Then, on any view, the declaratory approach is inapt. In this context the declaratory approach has long been discarded. It is at odds with reality.

35. For present purposes the distinction between these two types of cases is not important. Nor is the declaratory theory. For present purposes what matters is the practical impact overruling may have in both types of cases. The question now under consideration is whether, having regard to this practical impact, it is necessarily and always beyond the competence of the House as the supreme court in this country ever to limit the temporal effect of its ruling.

36. Before answering this question I must mention the judicial role in respect of statute law. Under [section 4 of the Human Rights Act 1998](#) the court has an evaluative role in respect of primary legislation when considering whether to make a declaration of incompatibility. That apart, the essential function of the courts in respect of statutes is to apply and give effect to them. In cases of dispute the courts decide what, properly understood ("interpreted"), the legislation means. From time to time cases arise where changed social conditions dictate that a statutory provision should have a different and wider meaning than when enacted. *Fitzpatrick v Sterling Housing Association Ltd* [2001] 1 AC 27 is an instance of this. The House decided that by 1994 the long-term homosexual partner of a [Rent Act](#) tenant was "a member of the original tenant's family" even though that phrase would not have been so interpreted when the statutory provisions were first enacted in 1920. Such cases, arising out of changed circumstances, are exceptional.

37. There is another way courts can find themselves obliged to give a "dynamic" interpretation to statutes. [Section 3 of the Human Rights Act 1998](#) requires courts to read and give effect to legislation in a way which is compatible with Convention rights so far as it is possible to do so. When interpreting Convention rights courts must take into account decisions of the European Court of Human Rights: [section 2\(1\)](#). As already noted, that court gives an evolving interpretation to the principles embedded in the European . Thus, indirectly, through changes in the interpretation and application of Convention rights, the courts of this country may find it necessary to give legislation a changed meaning.

38. Cases of these types are of increasing importance. But leaving these aside, the interpretation the court gives an Act of Parliament is the meaning which, in legal concept, the statute has borne from the very day it went onto the statute book. So, it is said, when your Lordships' House rules that a previous decision on the interpretation of a statutory provision was wrong, there is no question of the House changing the law. The House is doing no more than correct an error of interpretation. Thus, there should be no question of the House overruling the previous decision with prospective effect only. If the House were to take that course it would be sanctioning the continuing misapplication of the statute so far as existing transactions or past events are concerned. The House, it is said, has no power to do this. Statutes express the intention of Parliament. The courts must give effect to that intention from the date the legislation came into force. The House, acting in its judicial capacity, must give effect to the statute and it must do so in accordance with what it considers is the proper interpretation of the statute. The House has no suspensive power in this regard. In *Ha v State of New South Wales* (1997) 189 CLR 465, 503-504, 515, the High Court of Australia unanimously considered "it would be a perversion of judicial power to maintain in force that which is acknowledged not to be the law". This would especially be so where "non-compliance with a properly impugned statute exposes a person to criminal prosecution".

Conclusion

39. The objections in principle and difficulties in practice mentioned above have substance, particularly in respect of the traditional interpretation of statutes. These objections are compelling pointers to what should be the normal reach of the judicial process. But, even in respect of statute law, they do not lead to the conclusion that prospective overruling can never be justified as a proper exercise of judicial power. In this country the established practice of judicial precedent derives from the common law. Constitutionally the judges have power to modify this practice.

40. Instances where this power has been used in courts elsewhere suggest there could be circumstances in this country where prospective overruling would be necessary to serve the underlying objective of the courts of this country: to administer justice fairly and in accordance with the law. There could be cases where a decision on an issue of law, whether common law or statute law, was unavoidable but the decision would have such gravely unfair and disruptive consequences for past transactions or happenings that this House would be compelled to depart from the normal principles relating to the retrospective and prospective effect of court decisions.

41. If, altogether exceptionally, the House as the country's supreme court were to follow this course I would not regard it as trespassing outside the functions properly to be discharged by the judiciary under this country's constitution. Rigidity in the operation of a legal system is a sign of weakness, not strength. It deprives a legal system of necessary elasticity. Far from achieving a constitutionally exemplary result, it can produce a legal system unable to function effectively in changing times. "Never say never" is a wise judicial precept, in the interest of all citizens of the country.

*700

42. Moreover, in one particular context the courts' ability to give a ruling having only prospective effect seems irresistible. As noted above, at times the Strasbourg court interprets and applies the [European Convention on Human Rights](#) with prospective effect only. It would be odd if in interpreting and applying Convention rights the House was not able to give rulings having a comparable limited temporal effect: see Lord Rodger of Earlsferry, "A Time for Everything under the Law: Some Reflections on Retrospectivity", (2005) 121 LQR 57, 77.

43. I turn to the present case. In my view it is miles away from the exceptional category in which alone prospective overruling would be legitimate. No doubt over the years the clearing banks, including the respondent bank, have to some extent relied upon the *Siebe Gorman decision [1979] 2 Lloyd's Rep 142* when formulating and using their standard forms of charges on book debts. But banks and others who lend money on the security of charges on a company's undertaking are sophisticated operators. There is no reason to suppose this decision lulled them into a false sense of security. The *Siebe Gorman* case was a first instance decision. It cannot have been regarded as definitively settling the law in this field. Moreover, if the firm and unanimous decision now being given by the House were given prospective effect only, the result would be that in many existing liquidations preferential creditors would be deprived of the priority Parliament intended they should have. I would reject the bank's submission that this decision of the House should have only prospective effect. I would allow this appeal accordingly.

LORD STEYN

44. My Lords, I have had the advantage of reading the opinions of my noble and learned friends, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. I am in full agreement with their opinions.

45. In regard to prospective overruling I see the good sense of not saying "never" as explained by my noble and learned friend, Lord Nicholls of Birkenhead. On the other hand, like Lord Scott, at present I find it difficult to see how it could be possible to permit prospective overruling in a dispute about the interpretation of a statute.

46. I would also make the order which Lord Scott proposes.

LORD HOPE OF CRAIGHEAD

47. My Lords, as so often happens when a company goes into creditors' voluntary liquidation, the assets which are available to pay Spectrum's general creditors are insufficient to pay those creditors in full after payment of the preferential debts of the company. [Section 175\(2\)\(b\) of the Insolvency Act 1986](#), re-enacting a rule that was first introduced over 100 years ago by the [Preferential Payments in Bankruptcy Amendment Act 1897](#) provides that, so far as the assets of the company available for payment of general creditors are insufficient to meet them, preferential debts have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the company, and that they shall be paid accordingly out of any property comprised in or subject to that charge. It is notorious that this state of affairs operates to the disadvantage of creditors whose claims are secured by a charge which takes the form of a floating charge and not *701 that of a fixed security. From the creditor's point of view, it deprives the floating charge of much of its utility.

48. [Section 251](#) of the 1986 Act provides that the expression "floating charge" means "a charge which, as created, was a floating charge and includes a floating charge within the meaning of [section 462 of the Companies Act](#) (Scottish floating charges)". [Section 462\(1\) of the Companies Act 1985](#), which makes provision for the creation of floating charges in Scotland, states:

"It is competent under the law of Scotland for an incorporated company ... for the purpose of securing any debt or other obligation (including a cautionary obligation) incurred or to be incurred by, or binding upon, the company or any other person, to create in favour of the creditor in the debt or obligation a charge, in this Part referred to as a floating charge,

over all or any part of the property (including uncalled capital) which may from time to time be comprised in its property and undertaking."

That provision must be read together with [section 463\(1\)\(b\)](#) of the 1985 Act, which declares that where a Scottish company goes into liquidation within the meaning of [section 247\(2\) of the Insolvency Act 1986](#) a floating charge created by the company attaches to the property then comprised in the company's property and undertaking or, as the case may be, in part of that property and undertaking, but does so subject to the rights of any person who holds a fixed security over the property or any part of it ranking in priority to the floating charge. It must also be read together with [section 464\(6\)](#) the 1985 Act as amended by [section 439\(1\) of and Schedule 13](#) to the 1986 Act, which states that the order of ranking set out in that section is subject to [sections 175 and 176](#) of the 1986 Act as to the ranking of preferential debts in winding up. So the rule that was first introduced by the 1897 Act for England and Wales applies to Scottish floating charges too.

49. Prior to 1961 it was impossible for a Scottish company to create a floating charge over the whole or any part of its property and undertaking. In *In re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, 226 Lord Hoffmann, speaking of English law, said that a charge is a security interest created without any transfer of title or possession to the beneficiary. But a charge could not be created without any transfer of title or possession in Scotland. In *Carse v Coppin* 1951 SC 233, it was conceded that a company registered in Scotland could not create a valid and effectual floating charge over its assets in Scotland, but it was contended that it had done so over its assets in England. This argument was rejected. Lord President Cooper said, at p 239, that a floating charge was utterly repugnant to the principles of Scots law, which did not recognise it as creating a security at all. He referred, at p 241, to that fact that the reforms in the law which had been effected because of the many criticisms that had been directed against the injustices capable of being inflicted on the trade creditors by the use of floating charges had been expressly confined to companies registered in England. He said that it was unthinkable that this could have been done except upon the view that companies registered in Scotland and subject to Scots law could not create floating charges.

*702

50. This situation was thought to be to the disadvantage of Scottish companies. So the law of Scotland was amended by the [Companies \(Floating Charges\) \(Scotland\) Act 1961](#), later extended by the [Companies \(Floating Charges and Receivers\) \(Scotland\) Act 1972](#), to enable Scottish companies to give security in this way. The result, in the words of Professor W A Wilson, "Floating Charges", 1962 SLT (News) 53, was that there was now in the law of Scotland a completely new form of security which could be effectively granted over corporeal moveables without relinquishing possession, over incorporeal moveables without giving intimation and over heritage without recording a deed in the Sasine Register. It was, if I may respectfully borrow this phrase from the speech of my noble and learned friend, Lord Walker of Gestingthorpe, a cuckoo in the nest of Scots property law—as your Lordships were to discover in the case of *Sharp v Thomson* 1997 SC (HL) 66, which revealed some of the problems caused by introducing this form of charge into a legal system to which it did not belong naturally.

51. It is, of course, possible under the statutory regime that now applies in Scotland—it is currently to be found in [Part XVIII](#) of the 1985 Act—for a company to create a floating charge over its book debts. Indeed, a creditor seeking to secure his debt by means of a floating charge will usually wish to see to it that the property over which the charge extends includes the book debts of the company. But subjecting book debts to a security which will be effective as a fixed charge in Scots law, and will thus escape from the priority which [section 175](#) of the 1986 Act gives to preferential debts, is far less convenient in practice. This is because the law of Scotland still insists that a fixed charge can be created only by delivery of the property which is to be subjected to it into the hands of the creditor or by the equivalent of delivery. The only way in which this can be done in the case of book debts is by obtaining an assignation in security of the right to receive payment of the debt, which is then intimated to the party who is liable to pay the debt to the company. A company which wishes to continue to trade is unlikely to find this method of creating a charge over its book debts acceptable: *Fletcher & Roxburgh*, *The Law and Practice of Receivership in Scotland* 3rd ed (2005), para 2.10. In practice, therefore, a creditor who wishes to obtain a security from a Scottish company over its book debts will only be able to do this by way of a floating charge.

52. The creation of a charge over book debts which will be effective in English law as a fixed charge does not present the same difficulties. As Slade J said in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, 158, the decision of the House of Lords in *Tailby v Official Receiver* (1888) 13 App Cas 523 showed that it is competent for anyone to whom book debts may accrue in the future to create for good consideration an equitable charge upon those book debts which will attach to them as soon as they come into existence. But if this is to be effective as a fixed security everything depends on the way the security agreement ensures that the charge over the book debts is fixed. It is not easy to reconcile the company's need to continue to collect and use these sums for its own business purposes with the lender's wish to escape from the priority which [section 175\(2\)](#)

(b) of the 1986 Act gives to preferential debts over the claims of the holder of a floating charge by subjecting the uncollected book debts to a security which will operate as a fixed charge over them. *703 *Did Spectrum's debenture create a fixed charge?*

53. My noble and learned friend, Lord Scott of Foscote, has described the facts of the case and summarised all the relevant authorities. I adopt with gratitude all that he has said about them, and I agree with him that the charge which the company granted by way of what the debenture described as a specific charge over its book debts and other debts then and from time to time owing to the company was in law a floating charge. It was not a fixed charge, so [section 175\(2\)\(b\)](#) applies to it. The preferential creditors have priority over the bank's claims under the debenture to the sums realisable from the book debts and other debts of the company.

54. There are, as Professor Sarah Worthington has pointed out, a limited number of ways to ensure that a charge over book debts is fixed: "An 'Unsatisfactory Area of the Law'—Fixed and Floating Charges Yet Again" (2004) 1 *International Corporate Rescue* 175, 182. One is to prevent all dealings with the book debts so that they are preserved for the benefit of the chargee's security. This is the only method which is known to Scots law which, as I have said, insists upon assignation of the book debts to the security holder and its intimation to the company's debtor as the equivalent of their delivery. One can, of course, be confident where this method is used that the book debts will be permanently appropriated to the security which is given to the chargee. But a company that wishes to continue to trade will usually find the commercial consequences of such an arrangement unacceptable. Another is to prevent all dealings with the book debts other than their collection, and to require the proceeds when collected to be paid to the chargee in reduction of the chargor's outstanding debt. But this method too is likely to be unacceptable to a company which wishes to carry on its business as normally as possible by maintaining its cash flow and its working capital. A third is to prevent all dealings with the debts other than their collection, and to require the collected proceeds to be paid into an account with the chargee bank. That account must then be blocked so as to preserve the proceeds for the benefit of the chargee's security. A fourth is to prevent all dealings with the debts other than their collection and to require the collected proceeds to be paid into a separate account with a third party bank. The chargee then takes a fixed charge over that account so as to preserve the sums paid into it for the benefit of its security.

55. The method that was selected in this case comes closest to the third of these. It was selected, no doubt, because it enabled the company to continue to trade as normally as possible while restricting it, at the same time, to some degree as to what it could do with the book debts. The critical question is whether the restrictions that it imposed went far enough. There is no doubt that their effect was to prevent the company from entering into transactions with any third party in relation to the book debts prior to their collection. The uncollected book debts were to be held exclusively for the benefit of the bank. But everything then depended on the nature of the account with the bank into which the proceeds were to be paid under the arrangement described in clause 5 of the debenture. As McCarthy J said in *In re Keenan Bros Ltd* [1986] *BCLC* 242, 247, one must look, not at the declared intention of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention. Was the account one which allowed the company to continue to use the proceeds of the book debts as a source of its cash flow or was it one which, on the contrary, *704 preserved the proceeds intact for the benefit of the bank's security? Was it, putting the point shortly, a blocked account?

56. I do not see how this question can be answered without examining the contractual relationship in regard to that account between the bank and its customer. An account from which the customer is entitled to withdraw funds whenever it wishes within the agreed limits of any overdraft is not a blocked account. In *Agnew v Comr of Inland Revenue* [2001] 2 *AC* 710, 722, para 22 Lord Millett said that the critical feature which led the Irish Supreme Court in *In re Keenan Bros Ltd* [1986] *BCLC* 242 to characterise the charge on book debts as a fixed charge was that their proceeds were to be segregated in a blocked account where they would be frozen and unusable by the company without the bank's written consent. I respectfully agree. Elsewhere in his judgment he appears to have assumed that the account into which the proceeds of the book debts were to be paid under the debenture in the *Siebe Gorman* case [1979] 2 *Lloyd's Rep* 142 was also a blocked account: p 727, para 38; p 730, para 48. In para 38 he said that the company could collect the money but was not free to use it as it saw fit. The question whether he was right when he made that assumption is at the heart of this case.

57. For the reasons which have been explained much more fully by Lord Scott and Lord Walker, I too would hold that it is impossible to conclude that the debenture in the *Siebe Gorman* case had that effect. As I read the critical passage in Slade J's judgment, at pp 158-159, he appears to have reached that conclusion in two stages. First, he said, the effect of the debenture was to create a specific charge on the proceeds of the debts as soon as they were received which prevented the company from disposing of an unencumbered title to them without the mortgagor's consent. Second, he said that the bank would have had the right, if it chose, to assert its lien under the charge on the proceeds of the book debts, even at a time when the account into which they were paid was temporarily in credit.

58. As to the first point, I would agree that the effect of clause 5(c) of the debenture (the equivalent of clause 5 in our case) was that the company was prevented from doing anything with the proceeds of the book debts when collected other than paying them into its account with the bank. But it seems to me that second point—that the bank could assert a lien over the proceeds—overlooks the fact that the account into which the proceeds were to be paid was the company's current account with the bank which the company was to continue to be free to operate for its own business purposes within the agreed limit of its overdraft.

59. As May LJ said in *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340, 1353, the money which a customer deposits with a bank becomes the bank's money, but the bank is prima facie bound to meet its debt when called upon to do so by the customer. In *Westminster Bank Ltd v Hilton* (1926) 43 TLR 124, 126 Lord Atkinson explained the relationship in this way:

"It is well established that the normal relation between a banker and his customer is that of debtor and creditor, but it is equally well established that quoad the drawing and payment of the customer's cheques as against money of the customer's in the banker's hands the relation is that of principal and agent. The cheque is an order of the *705 principal's addressed to the agent to pay out of the principal's money in the agent's hands the amount of the cheque to the payee thereof."

The general rule is that a banker is bound to honour his customer's cheque so long as he has funds in his hands if the account is in credit, or up to the agreed limit of any overdraft. He may determine the contract at any time on giving notice to the customer. But he cannot refuse to honour cheques drawn before the notice of determination is received.

60. A banker has a general lien over all bills, notes and negotiable instruments belonging to the customer which his customer may have deposited with him in security of the customer's indebtedness to the bank. But a lien is a right to retain possession of property that belongs to someone else, and the banker has no lien over funds which, when deposited in its account by the customer, become his own property. Moreover the relationship is one where, if the account is in credit, the banker is indebted to his customer. So it was a misuse of the word lien to say that the bank could assert a right of that kind over the proceeds: see Buckley LJ in the Court of Appeal in *Halesowen Presswork and Assemblies Ltd v National Westminster Bank Ltd* [1971] 1 QB 1, 46, and Viscount Dilhorne and Lord Cross of Chelsea in the same case in the House of Lords [1972] AC 785; Lord Hoffmann in *In re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, 226. This is not to say that it is impossible to conceive of the creation of an equitable charge over the proceeds of book debts paid into an account in the name the chargor. But the ordinary relationship of banker and customer does not permit the banker, without notice, to refuse to allow his customer to operate a current account as and whenever he wishes while it is credit or is within the limits of any agreed overdraft. The debenture in the *Siebe Gorman case* [1979] 2 Lloyd's Rep 142, which provided for the payment of the proceeds into an account of that kind, lacked any provision which qualified that relationship.

61. In the Court of Appeal Lord Phillips of Worth Matravers MR [2004] Ch 337, 383, para 94 said that, in the determination of the question whether the charge over the book debts was fixed, the extent of the customer's contractual right to draw out sums equivalent to the amounts paid in must be disregarded. But the relationship between a bank and its customer is founded in contract. The company's undertaking in clause 5 of the debenture to pay the proceeds of the book debts into its account with the bank has to be seen and understood in that context. This was a current account into which the company paid money drawn from a variety of other sources as well as the proceeds of its book debts. In my opinion the company's continuing contractual right to draw out sums equivalent to the amounts paid in is wholly destructive of the argument that there was a fixed charge over the uncollected proceeds because the account into which the proceeds were to be paid was blocked.

Should Siebe Gorman be overruled?

62. Lord Phillips of Worth Matravers MR said that, even if Slade J's construction of the debenture in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 had appeared to him to be erroneous, he would have been inclined to hold that the form of the debenture had, by custom and usage, acquired the meaning and effect that he had attributed to *706 it: [2004] Ch 337, 383, para 97. This was because the form had been used for 25 years under the understanding that this was its meaning and effect. Banks had relied upon this understanding, and individuals had guaranteed the liabilities of companies to banks on the understanding that the banks would be entitled to look first to their charges on book debts unaffected by the claims of preferred creditors. The respondents say that this is the course that ought now to be followed in the interests of commercial certainty.

63. The House's Practice Statement of 26 July 1966 reminds us that the use of precedent is an indispensable foundation on which to decide what is the law and how it should be applied in individual cases: *Practice Statement (Judicial Precedent)*

[1966] 1 WLR 1234 . It promotes the degree of certainty that is needed for the guidance of those who must regulate their affairs according to the law. It is hard to think of an area of the law where the need for certainty is more important than that with which your Lordships are concerned in this case. The commercial life of this country depends to a large extent on the reliability of the security arrangements that are entered into between debtors and their creditors. The law provides the context in which these arrangements are entered into, and it lays down the rules that have to be applied when the arrangements break down. Mistakes as to the law can make all the difference between success and failure when the creditor seeks to realise his security. So a heavy responsibility lies on judges to provide the lending market with guidance that is accurate and reliable. This is so that mistakes can be avoided and transactions entered into with confidence that they will achieve what is expected of them.

64. These are powerful considerations, but I am in no doubt that the proper course is for the *Siebe Gorman* decision to be overruled. It is a tribute to the great respect which Slade LJ's outstandingly careful judgments, both at first instance and the Court of Appeal, have always commanded that his decision in that case has remained unchallenged for so many years. But the fact is that it was a decision that was taken at first instance, and it has now been conclusively demonstrated that the construction which he placed on the debenture was wrong. This is not one of those cases where there are respectable arguments either way. With regret, the conclusion has to be that it is not possible to defend the decision on any rational basis. It is not enough to say that it has stood for more than 25 years. The fact is that, like any other first instance decision, it was always open to correction if the country's highest appellate court was persuaded that there was something wrong with it. Those who relied upon it must be taken to have been aware of this. It provided guidance, and no criticism can reasonably be levelled at those who felt that it was proper to rely on it. But it was no more immune from review by the ultimate appellate court than any other decision which has been taken at first instance.

Should *Siebe Gorman* be overruled prospectively?

65. Changes in the law do not occur in a vacuum. Much is likely to depend on whether the change affects situations before the change occurs or whether it affects only situations that come afterwards. On the whole legislation affects the future only and not the past, although awareness of what is to come may well influence the way people conduct their affairs before its commencement. The reverse is true of judicial decisions.

*707

66. In *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70 , 95, my noble and learned friend, Lord Nicholls of Birkenhead, said that prospective overruling was not yet a principle known in English law. Certainly it is as true today as it was then that it has not yet been adopted as a practice in this country: see para 12 of his speech in this case. But in *Kleinwort Benson Ltd v Lincoln City Council* [1992] 2 AC 349 , 378-379, Lord Goff of Chieveley declared that it had no place in our legal system. He said:

"Subject to consideration by appellate tribunals, and (within limits) by judges of equal jurisdiction, what [a judge] states to be the law will, generally speaking, be applicable not only to the case before him but, as part of the common law, to other comparable cases which come before the courts, whenever the events which are the subject of those cases in fact occurred. It is in this context that we have to reinterpret the declaratory theory of judicial decision ... when the judges state what the law is, their decisions do, in the sense I have described, have a retrospective effect. That is, I believe, inevitable. It is inevitable in relation to the particular case before the court, in which the events must have occurred some time, perhaps some years, before the judge's decision is made. But is also inevitable in relation to other cases in which the law as so stated will in future fall to be applied. I must confess that I cannot imagine how a common law system, or indeed any legal system, can operate otherwise if the law is to be applied equally to all and yet be capable of organic change."

Later in the same paragraph he said that a system of prospective overruling, although it had occasionally been adopted elsewhere, had no place in our legal system.

67. In *Ha v State of New South Wales* 189 CLR 465 , 503-504 the High Court of Australia was just as firm in its rejection of the invitation that it should, if it came to the conclusion that the tobacco wholesalers' and retailers' licence fees were invalid, overrule the franchise cases prospectively, leaving the authority of those cases unaffected for a period of 12 months:

"This court has no power to overrule cases prospectively. A hallmark of the judicial process has long been the making of binding decisions of rights and obligations arising from the operation of the law upon past events or conduct. The adjudication of existing rights and obligations as distinct from the creation of rights and obligations distinguishes the

judicial power from non-judicial power. Prospective overruling is thus inconsistent with judicial power on the simple ground that the new regime that would be ushered in when the overruling took effect would alter existing rights and obligations. If an earlier case is erroneous and it is necessary to overrule it, it would be a perversion of judicial power to maintain in force that which is acknowledged not to be the law."

68. I do not think that these declarations can be taken as the last word on this issue, at least so far as the powers of your Lordships' House are concerned. The ability of courts to make prospective rulings, if they have power to do so, can no longer be said to be in question. [Section 102 of the Scotland Act 1998](#) provides that, where a court declares that any provision in an Act of the Scottish Parliament is not within the competence [*708](#) of the Parliament, it may make an order removing or limiting the effect of the decision. Equivalent provisions are to be found in [section 110 of the Government of Wales Act 1998](#) and [section 88\(1\) of the Northern Ireland Act 1998](#). This power is a limited one, as it is available only where legislation is held to be invalid because it is outside the devolved institution's legislative competence. But it is nevertheless significant. The European Court of Justice has acknowledged that the interpretation it gives to a rule of Community law is limited to clarifying and defining the meaning and scope of that rule as it ought to have been understood and applied from the time of its coming into force: *R (Bidar) v Ealing London Borough Council (Case C-209/03 [2005] QB 812*, para 66. But, as the court said in the same case, it has in exceptional cases limited the temporal effect of its judgments, having regard to the principle of legal certainty, where it is satisfied that those concerned acted in good faith on the basis of the rules considered to be validly in force and that for it not to do so would give rise to serious economic difficulties: paras 67-69; see also the opinion of Advocate General Jacobs in *Banca Popolare di Cremona v Agenzia Entrate Ufficio Cremona (Case C-475/03)* 17 March 2005, para 75. This power has been developed by judicial decision notwithstanding the fact that there is no express treaty base in articles 230-231 EC for its exercise.

69. The fact that the Judicial Committee of the Privy Council has been given this power in devolution cases by statute and that a similar power has been developed by the European Court of Justice does not, of course, answer the question whether the House has the power, in exceptional cases, to do likewise. But it is for the House, as the ultimate court, to define the limits of its own jurisdiction. It can take as its starting point the inherent power which it has under the common law to do whatever is necessary to serve the interests of justice. That power is, of course, subject as our constitution requires to the doctrine of Parliamentary sovereignty. It must respect any limits on its jurisdiction that have may been imposed by Parliament, so long as these are compatible with our treaty obligations under Community law and with the rights that are defined by [section 1\(1\) of the Human Rights Act 1998](#) as the Convention rights. A statutory limitation which was found to be incompatible would have to be read down under the doctrine of direct effect or under [section 3\(1\)](#) of the 1998 Act to remove the incompatibility. Subject to these exceptions, its jurisdiction is limited only by the fact that the inherent power which is vested in the House in its appellate capacity is a judicial power, not a legislative one.

70. Authority for this approach, if it is needed, is to be found in *R v Bow Street Metropolitan Stipendiary Magistrate, Ex p Pinochet Ugarte (No 2) [2000] 1 AC 119* in which, in the exercise of its power as the ultimate court of appeal to correct any injustice caused by one of its own orders, the House set aside the decision which it had reached in the first appeal, *R v Bow Street Metropolitan Stipendiary Magistrate, Ex p Pinochet Ugarte [2000] 1 AC 61*. The respondents did not dispute that the House had jurisdiction in appropriate cases to rescind or vary one of its earlier orders. But Lord Browne-Wilkinson, who delivered the leading speech, went further. He said that in his judgment that concession was rightly made both in principle and on authority [2000] 1 AC 119, 132: [*709](#)

"In principle it must be that your Lordships, as the ultimate court of appeal, have power to correct any injustice caused by an earlier order of this House. There is no relevant statutory limitation on the jurisdiction of the House in this regard and therefore its inherent jurisdiction remains unfettered. In *Broome v Cassell & Co Ltd (No 2) [1972] AC 1136* your Lordships varied an order for costs already made by the House in circumstances where the parties had not had a fair opportunity to address argument on the point."

The circumstances in that case were, of course, quite different. But the principle which the House was applying there is capable of a much wider application.

71. The question then is whether it can ever be consistent with the exercise of its judicial power for the House to declare that a decision which it takes which changes the law is not to affect events or things done in the past but only events or things done in the future. While I recognise the force of Lord Goff's argument to the contrary in *Kleinwort Benson Ltd v Lincoln City Council [1992] 2 AC 349*, I think that it would be unwise to say that the power to do this can never be available in any circumstances.

The speeches that were delivered in *R v Governor of Brockhill Prison, Ex p Evans (No 2)* [2001] 2 AC 19 show how reluctant your Lordships have been to engage in this debate. It is no doubt true that in almost every case that can be imagined the exercise of the judicial power will require the House simply to declare what the law is, with the inevitable result that it will apply to other comparable cases whenever the events occurred. But it is not possible to predict the future with complete confidence, and it seems to me that the question whether this technique should be adopted remains an open one. Richard H S Tur, "Time and Law" (2002) 22 Oxford Journal of Legal Studies 463, 473, has observed that to apply an admittedly new rule retrospectively is blatantly legislative however fair or otherwise normatively appealing this may be. He said, at p 474, that commentators can agree that prospective overruling has, in Lord Goff's words, "no place in our legal system" but disagree as to whether it should have a place, adding that it might be that in exceptional circumstances, where justice was served thereby, the effect of a judicial decision could expressly be declared to be prospective only. I do not think that we can say that there will never be cases when the interests of justice may require the removal of the retrospective effect of a judgment by making a declaration to that effect.

72. The question whether such a declaration will ever be consistent with the exercise of the judicial power must, in the end, depend on the issue that the House is being called upon to decide. In *Arthur J S Hall & Co v Simons* [2002] 1 AC 615, 726h, for example, I said that I was of opinion that the decision in that case which changed the law about the immunity from suit of the advocate should take effect only from the date when the House delivered its judgment. That was a highly unusual case. In the Court of Appeal it was held that the solicitors had not acted as their clients' advocate and their conduct was not so intimately connected with the conduct of the case in court as to attract the immunity. I said at the outset of my speech that the grounds which the Court of Appeal had given for its decision were entirely sound, sufficient and satisfactory and that it was unnecessary for the disposal of the appeal to examine the fundamental question whether the core forensic *710 immunity which the House had recognised in *Rondel v Worsley* [1969] 1 AC 191 could still be justified on grounds of public policy. But the opportunity had been taken of arranging for the case to be heard by seven Law Lords so that it could be considered whether the rule that was established by that case could still be said to be justified. The focus of attention was shifted, quite deliberately, to this issue. The House was no longer interested in the question whether the Court of Appeal had been right to say that the solicitors' conduct was such as not to attract the core immunity. So I did not regard it as necessary for the disposal of the appeal to say that any change as regarded the immunity rule should operate retrospectively. On the contrary, as I said at p 710:

"I consider it to be a legitimate exercise of your Lordships' judicial function to declare prospectively whether or not the immunity—which is judge-made rule—is to be available in the future and, if so, in what circumstances."

73. I continue to think that this approach to the exercise of the judicial power in that case was legitimate. There was no need, in order to do justice between the parties to the disputes, for the decision in *Arthur J S Hall & Co v Simons* [2002] 1 AC 615 to be applied retrospectively. Advocates had arranged their affairs since the decision in *Rondel v Worsley* on the basis that in their conduct of cases in court the core immunity was available. Recognising the importance that is to be attached to legal certainty, there was much to be said for the view that in their case the decision to remove the immunity should operate prospectively only and not retrospectively.

74. Where the future may lead us we cannot tell. So, like my noble and learned friend, Lord Nicholls of Birkenhead, I would not rule out the possibility that in a wholly exceptional case the interests of justice may require the House, in the context of a dispute about the state of the common law or even about the meaning or effect of a statute, to declare that its decision is not to operate retrospectively. But I would not consider that approach to be appropriate in this case. The single most important point which indicates the contrary is that, if the decision to overrule *Siebe Gorman* were to be applied prospectively only, it would deprive the preferential claimants of the priority to which, on a correct view of the law, they are entitled under section 175(2)(b) of the 1986 Act. I do not think that it is open to your Lordships in the exercise of the judicial power to deprive a party to the litigation of a legitimate remedy that has undoubtedly been given to him by statute.

Conclusion

75. For the reasons given by Lord Scott and Lord Walker, and for these further reasons of my own, I would hold that the decision in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 was wrong and should be overruled. I would allow the appeal.

LORD SCOTT OF FOSCOTE

The issues

76. My Lords, the issue in this case is whether the charge over book debts, present and future, granted by Spectrum Plus Ltd ("Spectrum") to *711 National Westminster Bank Plc ("the bank") under a debenture dated 30 September 1997 was a fixed charge, which it was expressed to be, or merely a floating charge. The bank, naturally, says that it was a fixed charge. Customs and Excise, the Inland Revenue, and the Secretary of State for Trade and Industry ("the Crown creditors") say that it was a floating charge. If it was a floating charge Spectrum's preferential creditors are entitled to have their debts paid out of the proceeds of the book debts in priority to the bank (see [section 175, Insolvency Act 1986](#)). If it was not a floating charge the preferential creditors have no such priority and the bank will be entitled to the whole of the proceeds. The amount at stake is relatively trivial, no more than £16, 136 odd. But this is a test case. Your Lordships have been given to understand that several hundred liquidations are being held up pending the resolution of the issue (see the judgment of Sir Andrew Morritt V-C [2004] Ch 337, 342). Your Lordships have been told also that the debenture granted by Spectrum was in the bank's normal form and that many other banks and other commercial lenders have taken security over their borrowers' book debts using a similar form of debenture. It is of commercial as well as legal importance that the issue should be resolved.

77. There is a subsidiary issue. The bank has invited your Lordships, if your Lordships conclude that the debenture created merely a floating charge over the book debts, so to rule with prospective effect only. That raises the question whether your Lordships have power to deliver prospective rulings, applicable only in the future, or only to debentures not yet executed. There is also, of course, the question whether, if your Lordships do have such a power, the power should be exercised in the present case. But these are issues for later. The first and main issue is whether the bank's debenture created a fixed charge or only a floating charge over Spectrum's book debts.

The debenture

78. Spectrum carried on the business of a manufacturer of dyes, paints, pigments and other chemical products for the paint industry. In the autumn of 1997 Spectrum changed banks. It opened an account with the bank, obtained an overdraft facility of £250,000 and, on 30 September 1997, executed the debenture to secure its indebtedness to the bank. The security created by the debenture was expressed to include:

"A specific charge [of] all book debts and other debts ... now and from time to time due or owing to [Spectrum]" (para 2(v)) and "A floating security [of] its undertaking and all its property assets and rights whatsoever and wheresoever present and/or future including those for the time being charged by way of specific charge pursuant to the foregoing paragraphs if and to the extent that such charges as aforesaid shall fail as specific charges but without prejudice to any such specific charges as shall continue to be effective" (para 2(vii)).

79. The expression "specific charge" is potentially ambiguous. It may mean a charge over specific ascertained property or it may mean a fixed charge in contrast to a floating charge, depending on the context. It is clear that in this debenture, as in most others, the expression is intended to bear the latter meaning.

80. There is no doubt that, as Slade J held in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 , it is in law possible for a *712 company to create a security consisting of a fixed charge over all its present and future book debts. Nor is there any doubt that the question as to how a particular charge should be categorised depends upon the nature of the rights over the charged asset that have been granted to the chargee or reserved to the chargor. The label that the parties have attributed to the charge may be some indication of the rights the parties were intended to have but is not conclusive.

81. Para 5 of the debenture supported the grant of the charge over books debts:

"With reference to the book debts and other debts hereby specifically charged [Spectrum] shall pay into [Spectrum's] account with the bank all moneys which it may receive in respect of such debts and shall not without the prior consent in writing of the bank sell factor discount or otherwise charge or assign the same in favour of any other person or purport to do so and [Spectrum] shall if called upon to do so by the bank from time to time execute legal assignments of such book debts and other debts to the bank."

This provision barred Spectrum from dealing with its book debts in any of the ways specified but left Spectrum free to deal with the debtors who owed the debts and, in particular, to collect the debts in the normal course of business.

82. Para 5 required that the debts once collected be paid into Spectrum's account with the bank. This account was a current account. It enjoyed the overdraft facility of £250,000 to which I have referred. Provided that overdraft limit were not exceeded, Spectrum was free to draw on the account for its business purposes. The Bank's Borrowing Terms allowed the bank, by notice, to withdraw or reduce the facility. And amounts outstanding on the account were repayable on demand. These are the normal terms on which overdraft facilities are made available by banks to their customers. This account was in all respects a normal bank current account with an overdraft facility.

83. The question for decision, therefore, is whether a charge over present and future book debts, where the chargor cannot dispose of or charge the uncollected book debts but can deal with its debtors and collect the debts and where the chargor is obliged to place the payments made to it by its debtors in a designated account with the chargee bank but can freely draw on the account for its business purposes provided the overdraft limit is not exceeded, is capable in law of being a fixed charge.

The facts

84. The events that have led to this litigation can be shortly stated. After the opening of the current account in September 1997 Spectrum collected its book debts, paid them into its current account and drew on the account as it wished for its business purposes. The overdraft limit of £250,000 was never exceeded but nor was the account ever in credit. There is no evidence that any instructions regarding Spectrum's drawings from the account or how the account could be used by Spectrum were ever given by the bank or that the bank ever sought to exercise any control over the use made by Spectrum of its withdrawals from the account. But Spectrum's business fortunes did not prosper and on 15 October 2001 it went into voluntary liquidation. At the *713 date of liquidation £165,407 was due to the bank. Spectrum's uncollected book debts at that date had a face value of £291,293, but the liquidators estimated their realisable value to be £156,544. Spectrum's unsecured debts included the £16,136 due to preferential creditors, mainly the Crown creditors. There was a deficiency with regard to creditors in the region of £650,000.

85. The liquidators have so far collected £113,484 in respect of book debts but, pending a resolution of the issue as to the correct categorisation of the charge granted over the book debts, have not accounted for these payments to the bank. Bearing in mind, however, that even if the charge created only a floating charge the bank would be entitled to priority over ordinary creditors and that the amount due to preferential creditors is only £16,136, it seems a little surprising that the liquidators have not accounted to the bank for the balance of the £113,484. But no doubt there is some explanation for this.

The rival lines of judicial authority

86. The issue as to the correct categorisation of the charge created by Spectrum over its book debts has been presented, both in the courts below and before your Lordships, as requiring a choice between rival lines of judicial authority. In *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 Slade J held that the Barclays Bank debenture had created a fixed charge over the chargor's book debts. There are no material differences between the Barclays Bank debenture in issue in the *Siebe Gorman* case and the bank's debenture in the present case, at least so far as concerns the charge of book debts. The *Siebe Gorman* decision was followed by Knox J in *In re A Company (No 005009), Ex p Copp* [1989] BCLC 13 and has been referred to without dissent in other cases at first instance (see e.g. *In re Portbase Clothing Ltd* [1993] Ch 388, 395-396). Moreover in *In re New Bullas Trading Ltd* [1994] 1 BCLC 485, the Court of Appeal took *Siebe Gorman* a step further. The *New Bullas* debenture was expressed to grant a fixed charge over the chargor's present and future book debts but a floating charge over the proceeds of the debts when collected and paid into the chargor's bank account. Collection of the debts was left to the chargor. The chargor went into liquidation and Nourse LJ, with whose judgment the other two members of the court agreed, held that the charge over the book debts owing at the date of liquidation was, as the debenture had stated, a fixed charge. If a charge over book debts can be a fixed charge even though the money received by the chargor in payment of those debts is to be subject to only a floating charge, it becomes difficult to quarrel with the proposition that the charge over uncollected book debts in the present case (or in *Siebe Gorman*) can be a fixed charge even though the chargor can freely use for its business purposes the money it receives from its debtors in payment of the debts subject to the charge.

87. However Hoffmann J's judgment in *In re Brightlife Ltd* [1987] Ch 200 cast some doubt on the *Siebe Gorman* case. Hoffmann J was presented with a debenture expressed to grant a "first specific charge" of the chargor's book debts, present and future. The debenture did not allow the chargor to dispose of or charge the uncollected book debts but left the chargor free to collect the debts, pay the proceeds into its bank account and draw as it wished on that account. Hoffmann J held that the charge was a floating ***714** charge. He distinguished *Siebe Gorman* principally on the ground that the *Siebe Gorman* debenture holder was a bank and the debenture had required the collected debts to be paid into the chargor's account at the chargee bank. In *Brightlife* the debenture holder was not a bank and there was no similar restriction. I must revert to this point of distinction. It suffices for the moment to notice that, despite the description of the charge as a "first specific charge", the *Brightlife* charge was held to be a floating charge because the chargor had been left free to collect the debts, to pay the proceeds into its bank account and to use the account as it wished (see p.209). In the *New Bullas Trading Ltd case* [1993] BCLC 1389, Knox J, at first instance, followed *In re Brightlife Ltd*, but was reversed by the Court of Appeal. *In re Brightlife Ltd* was followed also by Millett LJ in *In re Cosslett (Contractors) Ltd* [1998] Ch 495.

88. In *Hoverd Industries Ltd v Supercool Refrigeration and Air Conditioning (1991) Ltd* [1994] 3 NZLR 300 Tompkins J, sitting in the High Court of New Zealand, declined to follow *Siebe Gorman*. The debenture in question, as in *Siebe Gorman* and the present case but unlike the debenture in *In re Brightlife Ltd*, was a bank debenture. It was expressed to grant a "fixed charge" over, among other assets, the chargor's book debts present and future. The debenture did not allow the chargor to dispose of or charge its uncollected book debts and required the collected debts to be paid into the chargor's account with the bank. There does not appear to have been any restriction on the ability of the chargor to draw on the account for its trading purposes. Tompkins J noted, at p 318, that "the relevant provisions of the securities in *Siebe Gorman* and the present case are, for practical purposes, the same" but held, at p 321, that the charge over the book debts was a floating charge because

"a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the Bank. It does not, without more, fasten the charge onto those proceeds."

89. And, finally, the same point came before the Privy Council on an appeal from the Court of Appeal of New Zealand in *Agnew v Comr of Inland Revenue* [2001] 2 AC 710. This case concerned a bank debenture closely modelled on the *New Bullas Trading Ltd* debenture, that is to say, it purported to grant the bank a fixed charge over the chargor's book debts present and future but only a floating charge over the proceeds collected by the chargor: see p 716. The judgment of the Board, delivered by Lord Millett, held that the critical feature which distinguished a floating charge from a fixed charge lay in the chargor's ability, freely and without the chargee's consent, to control and manage the charged assets and withdraw them from the security. *In re Brightlife Ltd*, *In re Cosslett (Contractors) Ltd* and the New Zealand *Supercool Refrigeration* case were approved and applied. *In re New Bullas Trading Ltd* was held to have been wrongly decided. *Siebe Gorman* was treated, in rather guarded terms, as a case in which Slade J had found sufficient restrictions on the use to which the chargor could put the collected debt payments to warrant the categorisation of the charge as a fixed charge: see p 727. But Lord Millett expressed the opinion, at p 726, para 36: ***715**

"A restriction on disposition [of book debts] which nevertheless allows collection and free use of the proceeds is inconsistent with the fixed nature of the charge; it allows the debt and its proceeds to be withdrawn from the security by the act of the company in collecting it."

The judgments in the courts below

90. The issue has, in the present case, been litigated between the bank on the one side, arguing for a fixed charge, and the Crown creditors on the other side, arguing for a floating charge. Spectrum in liquidation and its liquidators, although parties to the proceedings, have taken no active part.

91. Sir Andrew Morritt V-C [2004] Ch 337, having reviewed the cases, said that he was persuaded by Lord Millett's reasoning in *Agnew's* case that *Siebe Gorman* had been wrongly decided. He held that the charge granted to the bank over Spectrum's book debts was, notwithstanding that it was expressed to be a fixed charge, in law a floating charge. The test, he held at para 39, was whether the rights and obligations conferred and imposed by the debenture "disclosed an intention that the company should be free to deal with the book debts and withdraw them from the security without the consent of the bank". The application of

this test should, said Sir Andrew Morritt V-C at para 39, have led to the conclusion in *Siebe Gorman* that the charge was a floating charge: he said "the collection and free use of the proceeds of book debts through the ordinary operation of the bank account was not only permitted but envisaged."

92. Sir Andrew Morritt V-C referred in his judgment to the criticisms of the Court of Appeal decision in *In re New Bullas Trading Ltd* that had been made by Lord Millett in *Agnew's* case and to earlier criticisms of that decision made by Professor Roy Goode in an article, "Charges Over Book Debts: A Missed Opportunity" (1994) 10 LQR 592, but did not himself address Nourse LJ's reasoning or conclusions.

93. The Court of Appeal did so, however, when the present case reached them [2004] Ch 337. Lord Phillips of Worth Matravers MR pointed out, correctly in my respectful opinion, that Sir Andrew Morritt V-C's test of a floating charge was in conflict with the Court of Appeal decision in *In re New Bullas Trading Ltd* and concluded that the rules of binding precedent enabled neither Sir Andrew Morritt V-C nor a subsequent Court of Appeal to rule that that case had been wrongly decided: para 58. This conclusion would, I think, have made it inevitable that the appeal against Sir Andrew Morritt V-C's judgment would have been allowed but Lord Phillips MR went on to consider whether, assuming the *Agnew* test of a floating charge to be applicable, the bank's debenture had had the effect that the company had been left free to use the proceeds of its book debts in the normal course of its business. He concluded that the restrictions imposed by the debenture (and the restrictions imposed by the *Siebe Gorman* debenture) had been sufficient to justify the categorisation of the charge as a fixed charge, at para 94:

"It seems to me that it is at least arguable that a debenture which prohibits a chargor from disposing of book debts before they are collected and requires him to pay them, beneficially, to the chargee as and when they are collected properly falls within the definition of a fixed charge, regardless of the extent of his contractual right to draw out sums equivalent to the amount paid in. Strictly speaking the chargor is neither *716 entitled to dispose of the book debts before they fall due for payment, nor to dispose of the proceeds. What he does enjoy are contractual rights to payments, whether as lender or borrower, from the bank."

94. On this appeal, therefore, the main issue depends on two questions. First, what is the right test to be applied in order to categorise a charge as a floating charge? Second, if that test is applied in the present case, how should the bank's charge be categorised?

What is a floating charge?

95. It is helpful in answering this question to bear in mind the juridical history of floating charges and the reasons why a degree of statutory intervention became necessary. By the middle of the 19th century industrial and commercial expansion in this country had led to an increasing need by companies for more capital. Subscription for share capital could not meet this need and loan capital had to be raised. But the lenders required security for their loans. Traditional security, in the form of legal or equitable charges on the borrowers' fixed assets, whether land or goods, could not meet the need. The greater part of most entrepreneurial companies' assets would consist of raw materials, work in progress, stock-in-trade and trade debts. These were circulating assets, replaced in the normal course of business and constantly changing. Assets of this character were not amenable to being the subject of traditional forms of security. Equity, however, intervened. *Holroyd v Marshall (1862) 10 HL Cas 191* was a case in which a debtor had purported to grant a mortgage not only over his existing machinery but also over all the machinery which, during the continuance of the security, should be placed in his mill. The question arose whether the equitable title of the chargee in respect of new machinery that had been placed in the mill prevailed over the rights of a judgment creditor of the chargor/debtor. Could the chargee assert an equitable interest in the new machinery? Lord Campbell LC held that he could not. But the House of Lords reversed the decision, holding that

"immediately on the new machinery and effects being fixed or placed in the mill, they became subject to the operation of the contract, and passed in equity to the mortgagees", per Lord Westbury LC, at p 211, and that "in equity it is not disputed that the moment the property comes into existence, the agreement operates on it": per Lord Chelmsford, at p 220.

96. *Holroyd v Marshall* opened the way to the grant by companies of security over any class of circulating assets that the chargor company might possess. Acceptance that it was possible to do this became established by the 1870s. In *In re Panama*,

New Zealand and Australian Royal Mail Co (1870) LR 5 Ch App 318 the company simply charged its "undertaking and all sums of money arising therefrom". Gifford LJ held, at p 322, that "undertaking" meant "all the property of the company, not only which existed at the date of the debenture, but which might afterwards become the property of the company". He said also that the word "undertaking"

"necessarily infers that the company will go on, and that the debenture holder could not interfere until either the interest which was due was unpaid, or until the period had arrived for the payment of his principal, *717 and that principal was unpaid": see also *In re Florence Land and Public Works Co; Ex p Moor (1878) 10 Ch D 530*, 540.

The two features mentioned by Gifford LJ became the hallmark of the new form of security, namely, (1) a charge on the chargor company's assets, or a specified class of assets, present and future and (2) the right of the chargor company to continue to use the charged assets for the time being owned by it and to dispose of them for its normal business purposes until the occurrence of some particular future event. In *In re Colonial Trusts Corpn, Ex p Bradshaw (1879) 15 Ch D 465* Jessel MR referred to this form of security as a "floating security" (see at pp 468, 469 and 472) and in *Moor v Anglo-Italian Bank (1879) 10 Ch D 681*, 687 he contrasted the new form of security with a "specific charge" on the property of the company.

97. By the last decade of the 19th century this form of security, Jessel MR's "floating security", had become firmly established and in regular use. This new form of security, the floating charge, did not derive from statute. It had been bred by equity lawyers and judges out of the needs of the commercial and industrial entrepreneurs of the time. But the new form of security, notwithstanding its convenience for both borrowers and lenders, had its drawbacks for others. Those dealing with a company could not tell whether its circulating assets were subject to a charge that, if the company became insolvent or ceased business, would allow a debenture holder to "step in and sweep off everything": Lord Macnaghten in *Salomon v A Salomon & Co Ltd [1897] AC 22*, 53. And if a debenture holder did "step in and sweep off everything" there would be nothing left for unsecured creditors including, in particular, the company's employees to whom wages arrears might be owing.

98. Statutory intervention began in 1897 with the [Preferential Payments in Bankruptcy Amendment Act](#). Where a company was being wound-up or was in receivership [sections 2 and 3](#) of the 1897 Act gave preferential creditors, a class which included employees as well as Crown creditors, priority over the chargee under a floating charge, so far as payment of debts out of the assets subject to that charge was concerned. Preferential creditors had priority anyway over ordinary creditors and the sections did not disturb the priority over ordinary creditors to which the charge holder was entitled by virtue of the charge. These statutory provisions, with very little alteration, are now to be found in [sections 40](#) (receivership) and [175](#) (winding up) of the [Insolvency Act 1986](#). And in 1900 further statutory interventions required floating charges to be registered (see now [sections 395 and 396 of the Companies Act 1985](#)) and provided for floating charges created by an insolvent company within a short period before the commencement of its winding up to be invalid except to the extent of new money provided by the chargee: see now [section 245 of the Insolvency Act 1986](#). The statutes which first introduced these reforms did not attempt any definition of a "floating charge". Nor have any of their statutory successors done so. The expression has been taken to be self-explanatory. It bears the meaning attributed to it by judicial decision. But the judicial process over the years whereby the concept of a "floating charge" has been developed must, in my opinion, keep in mind the mischief that these statutory reforms were intended to meet and, in particular, that on a winding up or receivership preferential creditors were to have their debts paid out of the circulating *718 assets, sometimes referred to as "ambulatory" assets, of the debtor company in priority to a debenture holder with a charge over those assets.

99. The classic and frequently cited definition of a floating charge is that which was given by Romer LJ in the Court of Appeal in the *Yorkshire Woolcombers Association case [1903] 2 Ch 284*, 295:

"I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some further step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."

But it is important to notice that Romer LJ prefaced his definition with a qualification. He said:

"I certainly do not intend to attempt to give an exact definition of the term 'floating charge', nor am I prepared to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics ..."

The case came to this House under the name *Illingworth v Houldsworth [1904] AC 355*. In short ex tempore speeches their Lordships upheld the Court of Appeal. Lord Macnaghten described the case as "clear" and offered the following definition of a floating charge in contrast to a "specific charge", at p 358:

"A specific charge, I think, 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 affect 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."

100. And a few years later Buckley LJ in *Evans v Rival Granite Quarries Ltd [1910] 2 KB 979*, 999 similarly contrasted a "floating security" with a "specific security":

"[A floating security] is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security."

101. It is in the nature of commercial lenders to want the most effective security that they can get. It is in the nature of commercial borrowers to want to be able to carry on the business for the purposes of which they are borrowing money with as much freedom from restrictions imposed by their ^{*719} lenders that negotiation can achieve for them. But the lenders are usually in the stronger bargaining position and able to stipulate the terms to be included in the debenture which will constitute their security. So it is not in the least surprising to find attempts by lenders to obtain fixed charges as security rather than floating charges, thereby avoiding the need, if financial misfortune were to visit their borrowers, to yield priority to preferential creditors and also avoiding possible vulnerability under section 245 of the 1986 Act or its statutory predecessors. And it is not surprising to find borrowers agreeable to co-operate in these attempts provided their ability to carry on business in the normal way were not unduly impeded.

102. There was never any doubt that it was possible to create a fixed charge over a specific, ascertained book debt. And *Tailby v Official Receiver 13 App Cas 523* established that an assignment of future book debts would be effective to vest in the assignee an equitable interest in the future debts at the moment they became owing to the assignor. So there was no reason why a debenture should not be expressed to assign to the debenture holder, by way of security, the company's future book debts. But the question would still remain whether such an assignment, not being an out-and-out assignment as in *Tailby v Official Receiver* but an assignment by way of security, could be said to constitute a fixed security.

103. There was nothing much that the lenders could do about the third of the characteristics that Romer LJ had regarded as typical of floating charges. Most commercial borrowers would be unlikely to agree to grant charges over their circulating assets that did not enable them to use those assets for their normal business purposes. So it was natural for the quest for fixed charges to be concentrated on the prominence given by Lord Macnaghten in the *Yorkshire Woolcombers* case to the characteristic of a fixed charge as being a charge on "ascertained and definite property" As soon as a book debt is incurred and becomes owing to the chargor it constitutes an item of "ascertained and definite" property and would qualify as a possible object of a fixed charge. So a debenture expressed to grant a fixed charge over present and future book debts would be capable of creating a fixed charge over all such debts as and when they accrued due to the chargor company. Slade J so held in *Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142* and no one has suggested that in that respect he was wrong.

104. Moreover, the debenture could fortify the apparently fixed character of the charge by including a provision entitling the chargee to call for a formal written assignment by the chargor of the debts as they accrued. Such an assignment unaccompanied by written notice to the debtor would constitute the chargee equitable proprietor, and not simply equitable chargee, of the debt. The appearance of a fixed security would be fortified. It is not surprising, therefore, to find debentures containing provisions of this sort. The *Siebe Gorman* debenture did so. So did the bank's debenture in the present case. But the intention of the parties

that the charge over book debts created and fortified in this way would be a fixed charge has to take account also of Romer LJ's third characteristic of a floating charge, namely, that until some further step by way of intervention is taken by the chargee the chargor company can use the assets in question for its normal business purposes and, in using them, remove them from the security. The fact that a valid fixed charge over present and future book debts is capable of being *720 created does not answer the essential question whether a fixed charge over assets that remain at the disposal of the chargor can be created.

105. Slade J in the *Siebe Gorman case [1979] 2 Lloyd's Rep 142*, 158 inclined to the opinion that if the chargor of book debts, having collected the book debts,

"[had] had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit ... the charge on such book debts could be no more than a floating charge."

Hoffmann J in *In re Brightlife Ltd [1987] Ch 200*, 209, in a passage cited with approval by Lord Millett in *Agnew v Comr of Inland Revenue [2001] 2 AC 710*, 723, said that the significant feature of the *Brightlife* debenture was that the company was free to collect its debts and pay the proceeds into its bank account. He went on:

"Once in the account, they would be outside the charge over debts and at the free disposal of the company. In my judgment a right to deal in this way with the charged assets for its own account is a badge of a floating charge and is inconsistent with a fixed charge."

Similar conclusions were expressed in *In re Keenan Bros Ltd [1986] BCLC 242* in the Supreme Court of Ireland and by Tompkins J in the *Supercool Refrigeration case [1994] 3 NZLR 300*, in New Zealand.

106. The Privy Council in the *Agnew* case agreed with these decisions. Lord Millett pointed out, in para 13 of the Board's opinion, that Romer LJ's first two characteristics, although typical of a floating charge, were not distinctive of it. They were not necessarily inconsistent with a fixed charge. It was the third characteristic, Lord Millett said, which was the hallmark of a floating charge and distinguished it from a fixed charge.

107. I respectfully agree. Indeed if a security has Romer LJ's third characteristic I am inclined to think that it qualifies as a floating charge, and cannot be a fixed charge, whatever may be its other characteristics. Suppose, for example, a case where an express assignment of a specific debt by way of security were accompanied by a provision that reserved to the assignor the right, terminable by written notice from the assignee, to collect the debt and to use the proceeds for its (the assignor's) business purposes, ie, a right, terminable on notice, for the assignor to withdraw the proceeds of the debt from the security. This security would, in my opinion, be a floating security notwithstanding the express assignment. The assigned debt would be specific and ascertained but its status as a security would not. Unless and until the right of the assignor to collect and deal with the proceeds were terminated, the security would retain its floating characteristic. Or suppose a case in which the charge were expressed to come into existence on the future occurrence of some event and then to be a fixed charge over whatever assets of a specified description the chargor might own at that time. The contractual rights thereby granted would, in my opinion, be properly categorised as a floating security. There can, in my opinion, be no difference in categorisation between the grant of a fixed charge expressed to come into existence on a future event in relation to a specified class of assets owned by the chargor at that time and the grant of a floating charge over the specified class of assets with crystallisation taking place on the occurrence of that *721 event. I endeavoured to make this point in *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council [2002] 1 AC 336*, 357, para 63. Nor, in principle, can there be any difference in categorisation between those grants and the grant of a charge over the specified assets expressed to be a fixed charge but where the chargor is permitted until the occurrence of the specified event to remove the charged assets from the security. In all these cases, and in any other case in which the chargor remains free to remove the charged assets from the security, the charge should, in principle, be categorised as a floating charge. The assets would have the circulating, ambulatory character distinctive of a floating charge.

108. The debenture in *In re New Bullas Trading Ltd [1994] 1 BCLC 485* had features which illustrate the ingenuity of equity draftsmen in seeking to produce for their clients fixed charges out of circumstances that would normally be associated with floating charges. The debenture was expressed to grant the chargee a fixed charge over the company's present and future book debts. The chargee was entitled to demand that the debts be assigned to it, but never in fact made any such demand. The chargee was entitled to give the chargor instructions as to how the chargor should deal with its book debts, but apparently never in fact gave any such instructions, at any rate none prior to liquidation. The debenture left the chargor free to collect the debts and required the chargor to pay into a specified bank account all money it received in payment of the debts. The debenture then

provided that on payment of the money into the bank account the fixed charge would be released and replaced by a floating charge over the money in the account. The obvious intention of these provisions was that on the occurrence of a crystallisation event, e.g. liquidation, the uncollected book debts at that time would be subject to the fixed charge notwithstanding that if the debts had been paid prior to the crystallisation event the collected money would have been subject to only a floating charge. The preferential creditors would then enjoy no priority over the debenture holder so far as the uncollected debts were concerned.

109. Nourse LJ could see no reason in law to prevent the parties from providing for a fixed charge on book debts while uncollected but a floating charge on the money collected. He referred at p 492 to the question and answer posed by Lord Macnaghten in *Tailby v Official Receiver* 13 App Cas 523, 545:

"Between men of full age and competent understanding ought there to be any limit to the freedom of contract but that imposed by positive law or dictated by considerations of morality or public policy? The limit proposed is purely arbitrary, and I think meaningless and unreasonable."

These reservations, he thought, supported the view that it was open to contracting parties, if they wished to do so, to provide for a fixed charge on uncollected book debts but a floating charge on the money received in payment of those debts.

110. Lord Millett expressed the Board's disagreement with Nourse LJ's reasoning and conclusion. Essentially Lord Millett challenged the notion that the security rights granted over a book debt could be any greater than the rights, if any, granted over the money received in payment of the debts: see [2001] 2 AC 710, para 46. If a book debt were to be charged as security but with an accompanying provision that any money received from the *722 debtor in payment of the debt would belong to the chargor, the so-called "charge", whether expressed to be a fixed charge or a floating charge, would not be a security at all. It would not constitute a possible source for the repayment of the allegedly secured debt. As Lord Millett said, it would be worthless. If the accompanying provision were, instead, to say that any money received from the debtor would be subject to a floating charge, that provision would, in my opinion, necessarily describe and limit the nature of the charge over the receivable debt. And if the charge were to be expressed to be a fixed charge as respects the receivable debt but a floating charge as respects the money received from the debtor there would be an internal contradiction in the formulation of the charge. Since the essential value of a book debt as a security lies in the money that can be obtained from the debtor in payment it seems to me that Lord Millett was right in concluding that such a security should be categorised as a floating security and that the *New Bullas case* [1994] 1 BCLC 485 was wrongly decided.

111. In my opinion, 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. In the meantime the chargor is left free to use the charged asset and to remove it from the security. On this point I am in respectful agreement with Lord Millett. Moreover, recognition that this is the essential characteristic of a floating charge reflects the mischief that the statutory intervention to which I have referred was intended to meet and should ensure that preferential creditors continue to enjoy the priority that section 175 of the 1986 Act and its statutory predecessors intended them to have.

Did the bank's debenture create a fixed charge or only a floating charge?

112. If, as I think, the hallmark of a floating charge and a characteristic inconsistent with a fixed charge is that the chargor is left free to use the assets subject to the charge and by doing so to withdraw them from the security, how should the charge over book debts granted by the bank's debenture be categorised? The following features of the debenture and the arrangements regarding the bank account into which the collected debts had to be paid need to be taken into account: (1) the extent of the restrictions imposed by the debenture (para 81 above); (2) the rights retained by Spectrum to deal with its debtors and collect the money owed by them (para 81 above); (3) Spectrum's right to draw on its account with the bank into which the collected debts had to be paid, provided it kept within the overdraft limit (para 82 above); (4) the description "fixed charge" attributed to the charge by the parties themselves.

113. Restrictions on Spectrum's right to deal with its uncollected book debts go very little way, in my opinion, in supporting the characterisation of the charge as a fixed charge for the reasons I have given in criticising the *New Bullas* decision. It is restrictions on the use that Spectrum could make of the payments made by its debtors that are important. I have already cited the passage at p 158 from Slade J's judgment in the *Siebe Gorman case* [1979] 2 Lloyd's Rep 142, 158 (para 105 above) and need not repeat it. It makes the same point.

114. Moreover, the restrictions on Spectrum's right to deal with its uncollected book debts did not enable the bank to realise its security over *723 those uncollected book debts. The bank could not have sold the book debts without first taking some step or steps that would have given it the power to do so. In effect a crystallisation event would, I think, have had to take place. The value of the uncollected book debts as a security lay always in the money that could be obtained from the debtors in payment of those debts.

115. The bank's debenture required all payments of book debts received by Spectrum to be paid into its account with the bank. The money once received by the bank would become the bank's money and in return Spectrum's account would be credited with the amount that had been received. Whether the account was for the time being in credit or in debit the result of each payment would be the accrual to Spectrum of the right to withdraw from the account a corresponding amount for its normal business purposes.

116. An attempt has been made to justify the categorisation of the charge as a fixed charge by looking no further than the receipt by the bank, through the operation of the clearing system, of the proceeds of the cheques from Spectrum's debtors that were paid in by Spectrum. The consequent crediting of Spectrum's account with amounts equal to the proceeds of the cheques and Spectrum's ability to draw on that account for its business purposes is not inconsistent, it is suggested, with the categorisation of the charge over the book debts as a fixed charge. This is the point being made by Lord Phillips MR in para 94 of his judgment (cited in para 93 above). It was a point pressed before your Lordships by Mr Moss, counsel for the bank. Your Lordships should not, in my opinion, accept this argument. It seeks to perpetuate what I regard as the *New Bullas* heresy, namely, that the categorisation of a charge over book debts can ignore the rights of the chargor over the money received in payment of those debts. The expression "floating charge" has never been a term of art but is an expression invented by equity lawyers and judges to describe the nature of a particular type of security arrangement between lenders and borrowers. The categorisation depends upon the commercial nature and substance of the arrangement, not upon a formalistic analysis of how the bank clearing system works. If part of the arrangement is that the chargor is free to collect the book debts but must pay the collected money into a specified bank account, the categorisation must depend, in my opinion, on what, if any, restrictions there are on the use the chargor can make of the credit to the account that reflects each payment in.

117. The bank's debenture placed no restrictions on the use that Spectrum could make of the balance on the account available to be drawn by Spectrum. Slade J in the *Siebe Gorman case [1979] 2 Lloyd's Rep 142*, 158 thought it might make a difference whether the account were in credit or in debit. I must respectfully disagree. The critical question, in my opinion, is whether the chargor can draw on the account. If the chargor's bank account were in debit and the chargor had no right to draw on it, the account would have become, and would remain until the drawing rights were restored, a blocked account. The situation would be as it was in *In re Keenan Bros Ltd [1986] BCLC 242*. But so long as the chargor can draw on the account, and whether the account is in credit or debit, the money paid in is not being appropriated to the repayment of the debt owing to the debenture holder but is being made available for drawings on the account by the chargor.

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118. Slade J said that the debenture in the *Siebe Gorman case [1979] 2 Lloyd's Rep 142*, 159,

"[created] in equity 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."

But it is very difficult to see what feature of the arrangement between chargor and bank chargee in the *Siebe Gorman* case justified this conclusion. The debenture was on all fours with the debenture in the present case. There is nothing in the report of the case to suggest that the bank account into which the chargor had to pay the collected book debts was other than, as here, a normal bank current account on which the chargor could draw for its normal business purposes. In considering the cited passage it seems to me worth noting that the issues that Slade J had to decide in the *Siebe Gorman* case did not include the question whether the charge over book debts was a fixed charge or a floating charge. The main issue in the case was one of priority as between the bank chargee on the one hand and a subsequent assignee of the charged book debts on the other. This issue turned on notice. Did the subsequent assignee have notice of the bank's charge and the provision barring subsequent assignments? If the subsequent assignee did have notice, the bank would have priority. If not, the subsequent assignee would have priority. The categorisation of the charge did not matter.

119. Slade J in the *Siebe Gorman* case, Nourse LJ in the *New Bullas case [1994] 1 BCLC 485*, and Mr Moss in his submission on behalf of the bank in the present case, attributed considerable significance to the labels that the parties to the debenture had chosen to attribute to the charge over book debts. Mr Moss indeed argued that a debenture expressed to grant a fixed charge thereby limited by necessary implication the ability of the chargor to deal with the charged assets. He argued that Spectrum had no right without the consent of the bank to draw on the account into which the cheques received by Spectrum in payment of its book debts had to be paid. This limitation was, he said, an inevitable result of the grant by the debenture of the fixed charge. This argument, my Lords, puts the cart before the horse. The nature of the charge depends on the rights of the chargor and chargee respectively over the assets subject to the charge. The moneys in the bank account were assets subject to the charge. If the account had been treated as a blocked account, so long as it remained overdrawn, it would be easy to infer from a combination of that treatment and the description of the charge as a fixed charge that Spectrum had no right to draw on the account until the debit on the account had been discharged. But the account was never so treated. The overdraft facility was there to be drawn on by Spectrum at will. In the operation of the account there was never a suggestion that Spectrum needed to obtain the bank's consent before writing a cheque. The bank could, by notice, have terminated the overdraft facility, required immediate repayment of the indebtedness and turned the account into a blocked account. Pending such a notice, however, Spectrum was free to draw on the account. Its right to do so was inconsistent with the charge being a fixed charge and the label placed on the charge by the debenture cannot, in my opinion, be prayed in aid to detract from that right.

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120. The correct conclusion, in my opinion, is that the debenture, although expressed to grant the bank a fixed charge over Spectrum's book debts, in law granted only a floating charge. I think Sir Andrew Morritt V-C, save for the precedent point, was correct in his reasoning and his conclusion.

Prospective overruling

121. Mr Moss has submitted on behalf of the bank that if your Lordships should conclude that the *Siebe Gorman* debenture ought to have been held to have created a floating charge over the book debts your Lordships should so rule with prospective effect only. I take this submission to mean that the overruling of the *Siebe Gorman* case would not affect any debenture granted before the date on which your Lordship's opinions were made public. This submission raises two questions. The first is whether your Lordships, having come to a conclusion on some issue of disputed law and ruled accordingly, have any power to postpone the coming into effect of that ruling. The second question, if your Lordships do have that power, is whether this is a case in which it should be exercised.

122. My Lords, I find the second question a very easy one. I can see no good reason for postponing the effect of the overruling of *Siebe Gorman*. If *Siebe Gorman* had been a decision of this House and therefore, subject to subsequent legislative intervention or to an overruling of the decision pursuant to the 1966 *Practice Statement (Judicial Precedent) [1966] 1 WLR 1234*, a decision that settled the law with finality, I think your Lordships would have need to hesitate long before overruling. But the rulings of lower courts on points of law do not settle the law with finality. They never have done. It was natural that banks and other lenders taking security from corporate borrowers should have modelled their security on the debenture form that had achieved success in the *Siebe Gorman* case. But they would not, or at least should not, have done so on the footing that Slade J's judgment had finally settled the law. Mr Moss has submitted that the bank's lending decisions, whether to lend, how much to lend, how much interest to charge, and so on, were taken in the belief that the *Siebe Gorman* decision on fixed charges over book debts would stand, and that otherwise different decisions might have been taken. My Lords, I am highly sceptical. Banks are in business to receive and hold money for their customers and to lend on that money to others who want to borrow. This is a highly competitive business. The proposition, that the terms on which the bank would have allowed Spectrum a £250,000 overdraft facility would have been significantly different if it had known that its charge over Spectrum's present and future books would be no more than a floating charge, is one that, for me, carries no ring of conviction whatever.

123. The question whether the House has power to postpone the coming into effect of a ruling on a point of law does not, therefore, strictly arise. But your Lordships have had the advantage of detailed submissions on the point, not only from counsel for the bank and for the Crown creditors but also from Mr Ian Glick, who was appointed by the Attorney General, at their Lordships' request, to act as *amicus curiae* to assist your Lordships on this point. In these circumstances I think I should express my view on the point.

124. The question whether judges in giving judgments make law or simply declare existing law is one that has been debated by generations of law students in universities and law schools across the globe. It will continue *726 to be so. There is no single and absolute answer. There is no doubt that it is one of the functions of judges in a common law country to try and develop

the common law so that it serves the needs of the time. To that extent at least it is not controversial to say that judges make new law and it may be that in this area it would be open to the House to give a prospective ruling as to what the law would require of individuals in particular situations. Your Lordships' opinions in *Royal Bank of Scotland v Etridge plc (No 2)* [2002] 2 AC 773 may be regarded as an example.

125. But where the issue is as to the meaning of and effect that should be given to a statutory provision on which the rights of the litigating individuals turn, different considerations come into play. It may be a function of judges incrementally to develop the common law, but it is a duty of judges faithfully to interpret and apply the statutory law. This duty applies as much to the "always speaking" statute as to other statutes. The notion that a judge could decide what a statute meant and required and then announce that the effect of the ruling would be postponed for some period or other seems to me inconsistent with that duty. It is for Parliament, not judges, to decide when statutes are to come into effect. It is for judges to interpret and apply the statutes. Where interpretation and application of a statute is the issue, a prospective ruling would absent legislative authority (e.g. the provisions in the 1998 devolution legislation: see para 17 of the opinion of my noble and learned friend, Lord Nicholls of Birkenhead), appear to constitute an improper usurpation by the judiciary of the role of the legislature.

126. Lord Nicholls has reviewed in depth the jurisprudential pros and cons of a prospective overruling and has concluded that, even where interpretation and application of a statute is the issue, the door should be kept open for the possibility of such a ruling in an exceptional case (see para 39 of his opinion). I would respectfully agree with his comment about the wisdom of a "never say never" approach but find myself unable to visualise circumstances in which it would be proper for a court, having reached a conclusion as to the correct meaning of a statute, to decline to apply to the case in hand the statute thus construed. Section 1 of the Bill of Rights 1689 (1 Will & Mary, sess 2, c 2) declared that "the pretended power of suspending of laws, or the execution of laws, by regal authority, without consent of Parliament, is illegal". It is probably right that the exercise of judicial authority is not caught by the reference to "regal authority" in the Bill of Rights but your Lordships in this House exercise an appellate jurisdiction deriving from the Queen in Council and if the promoters of the Bill of Rights in 1689 had been asked whether there was a power in the House of Lords to suspend laws without the consent of Parliament I do not think it is difficult to guess what their answer would have been.

127. The present case requires a decision as to whether the bank's charge over Spectrum's book debts was a fixed charge or a floating charge. The decision is necessary because statute has given statutory priority to preferential creditors over debenture holders so far as payment of debts out of assets subject to a floating charge is concerned. If your Lordships decide the charge was a floating charge, it is not, in my opinion, open to your Lordships to deprive the preferential creditors of the rights given to them by statute. To do so would be to suspend a law that Parliament has enacted and would, in my opinion, be contrary to the spirit and, perhaps, the letter of the Bill of Rights. *727

Conclusion

128. For all these reasons, and for the reasons given by my noble and learned friend, Lord Walker of Gestingthorpe, with which I agree, I would allow this appeal and restore paras 1 and 2 of the order of Sir Andrew Morritt V-C. The bank must pay the costs here and below.

LORD WALKER OF GESTINGTHORPE

129. My Lords, I agree that this appeal should be allowed, and that the normal effect of allowing the appeal should not be limited in any way. I gratefully adopt the summary of the facts in the opinion of my noble and learned friend, Lord Scott of Foscote. I agree with his opinion on the substantive issue, and also with that of my noble and learned friend, Lord Hope of Craighead. But because of the general interest and importance of this appeal I wish to state my opinion in my own words.

The history of the floating charge

130. The origins and early history of the floating charge have been clearly explained in a lengthy passage in the opinion of the Privy Council, delivered by Lord Millett, in *Agnew v Comr of Inland Revenue* [2001] 2 AC 710, 717-721, paras 5-15. This passage shows how the development of the floating charge was enthusiastically encouraged by some of the great Chancery judges of the late 19th century, who were robust defenders of freedom of contract. But after the floating charge had, with great

rapidity, grown to maturity, there was something of a reappraisal. The floating charge had become a cuckoo in the nest of corporate insolvency.

131. Two quotations from speeches of Lord Macnaghten, eight years apart, serve to illustrate this. In *Tailby v Official Receiver* 13 App Cas 523 , 545, he said:

"It was admitted by the learned counsel for the respondent, that a trader may assign his future book debts in a specified business. Why should the line be drawn there? Between men of full age and competent understanding ought there to be any limit to the freedom of contract but that imposed by positive law or dictated by considerations of morality or public policy?"

But in *Salomon v A Salomon & Co Ltd* [1897] AC 22 , 53, he said:

"For such a catastrophe as has occurred in this case some would blame the law that allows the creation of a floating charge. But a floating charge is too convenient a form of security to be lightly abolished. I have long thought, and I believe some of your Lordships also think, that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is."

132. *Salomon v A Salomon & Co Ltd* was decided by this House on 16 November 1896. With remarkable promptness Parliament responded by enacting [sections 2 and 3 of the Preferential Payments in Bankruptcy](#) , applicable in winding-up and receivership respectively. These provisions did not give preference to the trade creditors whom Lord Macnaghten had in mind, but the mischief aimed at was the "scandal" to which Lord Macnaghten had referred. The widespread use of floating charges over trading stock, book debts and other circulating capital produced a situation in which a company's business might appear to be thriving and prosperous, with goods on its shelves and customers at its doors, until a sudden and unexpected crystallisation of a floating charge revealed that nothing at all was left for the company's unsecured creditors, even if they were preferential creditors.

133. The perceived mischief was therefore akin to that underlying the doctrine of reputed ownership in bankruptcy, that creditors should not be misled by appearances. The requirement for registration of floating charges, first introduced in 1900, had the same aim, and was comparable to the requirement for registration of bills of sale. In the United States of America the courts took the same line of thought a good deal further, and rejected floating charges as fraudulent in character: *Benedict v Ratner* (1925) 268 US 353.

134. [Sections 2 and 3](#) of the 1897 Act provided for the claims of preferential creditors to rank ahead of those secured by a floating charge. In doing so it referred to a "floating charge" without providing any statutory definition of that expression. Parliament evidently regarded the concept of a floating charge as sufficiently certain in meaning as not to require definition. Parliament took the same course when registration of floating charges was introduced in 1900, and in all later relevant statutes. The lack of a statutory definition, and the difficulties of providing a clear and comprehensive definition, were discussed by the Court of Appeal in *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 (especially a much-cited passage in the judgment of Romer LJ at p 295) and by this House on appeal in the same case under the name of *Illingworth v Houldsworth* [1904] AC 55 .

Upgrading the security to a fixed charge

135. These difficulties have not diminished over the years. [Sections 2 and 3](#) of the 1897 Act (now re-enacted, with a refinement as to timing, as [sections 175\(2\)\(b\) and 40\(2\)](#) respectively of the [Insolvency Act 1986](#)) make a floating charge more precarious as a security. Banks and other large commercial lenders have therefore tried, for understandable reasons, to upgrade their security by imposing fixed (and not merely floating) charges on parts of a trading customer's circulating capital, especially book debts. This chapter of commercial history has been described by Professor Sir Roy Goode QC in *Legal Problems of Credit and Security*, 3rd ed (2003), pp 121-123. In practice, most standard forms of debenture make the charge extend not just to book debts but to all present and future "book debts and other debts", the extent of which expression was considered by Hoffmann J in *In re Brightlife Ltd* [1987] Ch 200 , 204-205; but nothing turns on that in this appeal. In considering the practical effect of charges on debts it should be borne in mind that money paid into a trading company's bank account will not necessarily represent the

proceeds of debts of any description, especially if the trader is a retailer making a large number of cash sales, either over the counter or on a "cash with order" basis.

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136. Banks and their advisers have had some success in their efforts to upgrade their security. It is quite clear that a fixed charge on book debts, present and future, is conceptually possible. That was the most important point decided (or at any rate confirmed) by Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, and the Crown, the appellant in this appeal, does not seek to cast any doubt on that general proposition. The Crown challenges the decision on a much narrower point, that is the correct construction of the particular form of debenture which was before the court. But that narrow point is itself of considerable general importance because the *Siebe Gorman* form has become a precedent and has been widely used, either in precisely the same words or in very similar words, by numerous banks.

137. In the *Siebe Gorman* case, Slade J decided that the form of debenture before him did on its true construction restrict the borrower, R H McDonald Ltd ("McDonald") in making use of the proceeds of collected debts in the ordinary course of its business. Slade J clearly accepted that, in the absence of such a restriction, the charge on debts could not as a matter of law have been more than a floating charge, even though the parties described it as a fixed (or specific) charge. He said, at p 158:

"if I had accepted the premise that [McDonald] would have had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit, I would have been inclined to accept the conclusion that the charge on such book debts could be no more than a floating charge."

The Crown has little quarrel with that, except perhaps for the adjective "unrestricted".

The essential difference

138. This passage brings us close to the issue of legal principle, that is the essential difference between a fixed charge and a floating charge. 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. So long as the charge remains unredeemed, the assets can be released from the charge only with the active concurrence of the chargee. The chargee may have good commercial reasons for agreeing to a partial release. If for instance a bank has a fixed charge over a large area of land which is being developed in phases as a housing estate (another example of a fixed charge on what might be regarded as trading stock) it might be short-sighted of the bank not to agree to take only a fraction of the proceeds of sale of houses in the first phase, so enabling the remainder of the development to be funded. But under a fixed charge that will be a matter for the chargee to decide for itself.

139. Under a floating charge, by contrast, the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a *fund* of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the trader, and not the bank, to decide how to run its business. There is a detailed and helpful analysis of the matter, with full citation of authority, in Worthington's *Proprietary Interests in Commercial Transactions* (1996) pp 74-77; see also her incisive comment on this case ("An Unsatisfactory *730 Area of the Law-Fixed and Floating Charges Yet Again") in (2004) 1 *International Corporate Rescue* 175. So long as the company trades in the ordinary way (a requirement emphasised by Romer LJ in the *Yorkshire Woolcombers case* [1903] 2 Ch 284, 295, and by the Earl of Halsbury on appeal in the same case [1904] AC 355, 357-358) the constituents of the charged fund are in a state of flux (or circulation). Trading stock is sold and becomes represented by book debts; these are collected and paid into the bank; the trader's overdraft facility enables it to draw cheques in favour of its suppliers to pay for new stock; and so the trading cycle continues.

140. I have drawn attention to Slade J's reference to an "unrestricted" right to deal with the proceeds of collected debts. It is clear that not every restriction on a trader's freedom of action is a badge of a fixed charge: see *In re Brightlife Ltd* [1987] Ch 200, 209. A prohibition on factoring or otherwise dealing with uncollected debts does not prevent the trader from collecting the debts itself. But if the terms of the debenture were such as to require the trader to pay all its collected debts into the bank and to prohibit the trader from drawing on the account (so that the account is blocked), a charge on debts, described as a fixed or specific charge, would indeed take effect as such (see *In re Keenan Bros Ltd* [1986] BCLC 242, a decision of the Supreme Court of Ireland, followed by Morritt J in *William Gaskell Group Ltd v Highley* [1994] 1 BCLC 197). In those circumstances the chargee would be in control, prior to crystallisation, and the trader would be unable to trade in the ordinary way without the chargee's positive concurrence. In *Agnew's case* [2001] 2 AC 710, 730, para 48 Lord Millett pointed out that it was not enough to provide in the debenture for an account to be blocked, if it was not in fact operated as a blocked account.

141. Both sides agree that the label of "fixed" or "specific" (which I take to be synonymous in this context) cannot be decisive if the rights created by the debenture, properly construed, are inconsistent with that label. There is a fairly close parallel (first drawn, I think, by Hoffmann J in *In re Brightlife Ltd* [1987] Ch 200, 209 and often repeated) with the important distinction, in land law, between a lease and a licence: see the decision of this House in *Street v Mountford* [1985] AC 809. The distinction is clear in principle although landlords (in framing letting agreements) and banks (in framing debentures) may produce legal documents in a form which makes the principle difficult to apply. Whether or not it is appropriate to describe this by some disparaging term such as camouflage, it is the court's duty to characterise the document according to the true legal effect of its terms, as has been very clearly explained by Lord Millett in *Agnew's case* [2001] 2 AC 710, 725-726, para 32. In each case there is a public interest which overrides unrestrained freedom of contract. On the lease/licence issue, the public interest is the protection of vulnerable people seeking living accommodation. On the fixed/floating issue, it is ensuring that preferential creditors obtain the measure of protection which Parliament intended them to have. This public interest is unaffected by the changes in the classes of preferential creditors made by section 251 of the Enterprise Act 2002.

142. In my opinion Slade J did not, in the *Siebe Gorman case* [1979] 2 Lloyd's Rep 142, make any significant error in stating the general principles which apply. But he did not correctly construe the debenture which was before him in that case, and his decision on its construction has had surprisingly far-reaching consequences. *731

Siebe Gorman & Co Ltd v Barclays Bank Ltd

143. In his submissions on the *Siebe Gorman case* [1979] 2 Lloyd's Rep 142, Mr Moss mentioned that the judgment of Slade J was given after an eight-day trial. So it was, but that fact cannot by itself add weight to its authority. Only two pages of a 25-page judgment are directly concerned with whether the charge on McDonald's debts, although expressed in the debenture as a fixed charge, amounted in law to a floating charge. Slade J also had to resolve many disputed issues of fact, which were complicated by the death, before trial, of a key witness. He had to consider issues of estoppel and rectification (though he did not ultimately have to decide those issues.) He did have to decide a difficult issue as to priority of charges (and his judgment on that issue may be the main reason why the judgment was reported). Of the 17 authorities cited, only three appear to have been cited on the issue of characterisation of the charge.

144. The key passage in the judgment of Slade J, at pp 158-159, is set out in full in the judgment of Lord Phillips MR in this case [2004] Ch 337, 376, para 72. I have already quoted part of it, with which the Crown has little or no quarrel. The crucial passage which the Crown does criticise is as follows, at p 159:

"I see no reason why the court should not give effect to the intention of the parties, as stated in clause 3(d), that the charge should be a first fixed charge on book debts. I do not accept the argument that the provisions of clause 5(c) negative the existence of a specific charge. All that they do, in my judgment, is to reinforce the specific charge given by clause 3. The mere fact that there may exist certain forms of dealing with book debts which are not specifically prohibited by clause 5(c) does not in my judgment turn the specific charge into a floating charge. This conclusion that the charge is a specific charge involves the further conclusion that, during the continuance of the security, the bank would have the right, if it chose, to assert its lien under the charge on the proceeds of the book debts, even at a time when the particular account into which they were paid was temporarily in credit."

145. Mr Briggs, for the Crown, submitted that Slade J was wrong about the significance of clause 5(c) of the debenture, which provided that during the continuance of the security McDonald

"shall pay into the company's account with the bank all moneys which it may receive in respect of the book debts and other debts hereby charged and shall not without the prior consent of the bank in writing, purport to charge or assign the same in favour of any other person and shall if called upon to do so by the bank execute a legal assignment of such book debts and other debts to the bank."

The judge saw this as reinforcing the specific charge given by clause 3 (that is, the "label"). Its real significance, in my opinion, was that it did not in any way restrict McDonald from taking the most natural course for a trader in the ordinary way of business, that is collecting the debts and paying them into its current account with the chargee bank. I agree with the criticism by Alan

Berg, "Charges over Book Debts: A Reply" [1995] JBL 433, 445 that the judge's construction was based too much on linguistic considerations, in isolation from the matrix of facts in which the security was created.

*732

146. When the debenture was granted, McDonald had a single current account which was overdrawn at the outset, with an overdraft limit (see [1979] 2 Lloyd's Rep 142, 146-147 summarised in paras 62 and 63 of the judgment of Lord Phillips MR). It is the proper characterisation of a charge at the time of its creation that is important, and the various manoeuvres which took place in the last few weeks before McDonald's final collapse (summarised in paras 65-69 of Lord Phillips MR's judgment) cannot be relevant to the issue of characterisation. For at least a year after the grant of the debenture, McDonald was free to use its overdraft facility to recycle its book debts in the ordinary course of its business. Slade J seems, with great respect, to have overlooked that that was the crucial point. The bank could decide to intervene and alter the banker-customer relationship. Indeed it did so by blocking McDonald's account about seven weeks before it learned of the winding-up petition. But under the charges as created there was no such restriction, either in clause 5 (c) or elsewhere. The last sentence of the criticised passage which I have set out above (beginning "This conclusion that the charge is a specific charge involves the further conclusion that") was not, as its language makes perfectly clear, reinforcing the first conclusion with a second line of reasoning. It was drawing a further (incorrect) conclusion from the first (incorrect) conclusion.

Later authority

147. Like Sir Andrew Morritt V-C [2004] Ch 337, 355, para 39, I feel the greatest hesitation and reluctance in disagreeing with a decision of Slade J. Indeed, the very high respect in which his judgments have always been held must have contributed to the enduring influence which *Siebe Gorman* has had. In their printed case Mr Moss and Mr Goldring assert that *Siebe Gorman* has been approved or accepted in many subsequent cases, and in England has not (until Sir Andrew Morritt V-C's decision) been held to be wrongly decided, or regarded as limited to its own facts.

148. That is very largely correct, although I do detect some inclination on the part of experienced Chancery judges to treat the decision as turning on a particular (and not fully explained) point of construction. That is my reading of Hoffmann J's observations in *In re Brightlife Ltd* [1987] Ch 200, 210 and of Lord Millett's observations in *Agnew's case* [2001] 2 AC 710, 727, para 38. In *In re Portbase Clothing Ltd* [1993] Ch 388, 396, Chadwick J made clear that he did not have to consider, and was not considering, whether *Siebe Gorman* was rightly decided. In the only English case in which *Siebe Gorman* was directly challenged, *In re A Company (No 005009), Ex p Copp* [1989] BCLC 13, the grounds of challenge were curiously oblique, no doubt in recognition of the fact that a first-instance Chancery judge would be very inclined to follow Slade J (as Knox J did) unless some point of distinction could be established.

149. In New Zealand the *Siebe Gorman* case has not been followed at first instance (the Court of Appeal of New Zealand found it unnecessary to decide this point): *Hoverd Industries Ltd v Supercool Refrigeration and Air Conditioning (1991) Ltd* [1994] 3 NZLR 300; [1995] 3 NZLR 577. In relation to a debenture in the *Siebe Gorman* form Tompkins J stated [1994] 3 NZLR 300, 321: *733

"It is my conclusion that a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the bank. It does not, without more, fasten the charge onto those proceeds. Supercool was free to deal with those proceeds except in the two respects stated, unless and until the BNZ intervened in a manner that would effectively inhibit that freedom."

I consider that that would be a correct statement of the position under English law.

150. A debenture in the *Siebe Gorman* form has also been considered by the Supreme Court of Ireland in *In re Holidair Ltd* [1994] 1 ILRM 481. *Siebe Gorman* was not cited. But the reasoning of Blayney J (with whom three other members of the court agreed) is compelling, at p 493:

"I am satisfied, accordingly, that the correct construction of the clause is that the trustee had a discretion to determine into what company account with what bank the proceeds of book debts should be paid from time to time. But there is no restriction in the clause on the companies drawing the monies out of these accounts. Accordingly, there is nothing in it to prevent the companies from using the proceeds of the book debts in the normal way for the purpose of carrying on their

business. By reason of this the charge has also the third characteristic referred to by Romer LJ in his judgment in the case of *In re Yorkshire Woolcombers' Association Ltd* and is accordingly a floating charge and not a fixed charge."

151. In *In re New Bullas Trading Ltd [1994] 1 BCLC 485*, the Court of Appeal, differing from Knox J [1993] BCLC 1389 upheld as a fixed charge a charge expressed as a fixed charge on book debts until they were collected, coupled with the requirement for them to be paid into a specified bank account (the chargee was not itself a bank) and a floating charge on the proceeds in the bank account. This decision was not followed by the Court of Appeal of New Zealand in *Comr of Inland Revenue v Agnew [2000] 1 NZLR 223* (the headnote is mistaken in referring to the decision of the Court of Appeal in *New Bullas* as having been adopted; it was either distinguished or left in the air). *Agnew's* case then came on appeal to the Privy Council [2001] 2 AC 710, which upheld the Court of Appeal of New Zealand and in doing so strongly disapproved of *New Bullas*. Mr Moss has not sought to defend *New Bullas* and it may not be strictly necessary for your Lordships to express any view about it. But for my part I am sure that the Privy Council was correct in *Agnew*, and this House has already gone some way to approving *Agnew* in *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council [2002] 1 AC 336*, 352. The essential fallacy in the *New Bullas* case has been explained by Professor Worthington in a note, "Fixed Charges Over Book Debts and Other Receivables" (1997) 113 LQR 562:

"the categorisation of a charge over receivables requires examination of the permitted dealings with collected proceeds *only* in order to clarify whether the chargor is free to deal with the charged asset itself (the receivable) in the ordinary course of business without the consent of the chargee. This, and nothing else, is the hallmark of a floating charge."

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The judgments below

152. Having covered most of the ground already I can set out quite shortly my views on the judgments of Sir Andrew Morritt V-C and the Court of Appeal [2004] Ch 337. Sir Andrew Morritt V-C held that *Siebe Gorman* was indistinguishable but wrongly decided. The Court of Appeal (Lord Phillips of Worth Matravers MR, Jonathan Parker and Jacobs LJ) reversed Sir Andrew Morritt V-C in a single judgment of Lord Phillips MR with which the other members of the court agreed.

153. In my respectful opinion Sir Andrew Morritt V-C was correct on every point in his judgment except one, which does not present any obstacle to your Lordships (that is as to the relative authority as precedents of the *New Bullas* and *Agnew* cases). On every point of substance I agree with Sir Andrew Morritt V-C's analysis and conclusions. In particular, I agree with his reasons for holding that the *Siebe Gorman* case was not distinguishable, at p 347, paras 15 and 16:

"Counsel for the bank points out that the observations of Slade J were directed to an account which was in credit. By contrast in this case the account was when opened and at all times thereafter in debit. He submits that the payment of the proceeds of a book debt into an overdrawn bank account prevents its further identification or tracing through such debit balance so that it cannot be contended that the company thereby enjoyed an unrestricted use of that book debt or of those proceeds. It is convenient to deal with this point at this stage. I do not think that any distinction is to be drawn for this purpose between the operation of an account which is in credit and the operation of one which is in debit but within the overdraft facilities agreed with the bank. The question is not whether the subsequent drawings by the company can be traced to or identified as the proceeds of a previous book debt but whether the charge when created contemplated that the company should continue to trade and should until the occurrence of some specified future event be free to use in such trade the class of asset described as book debts."

Sir Andrew Morritt V-C then referred to the classic statements in the *Yorkshire Woolcombers* case [1903] 2 Ch 284, 289 and *Illingworth v Houldsworth [1904] AC 355*, 357-358.

154. I also agree with Sir Andrew Morritt V-C's reasons for declining to follow the *Siebe Gorman* case. He referred to the critical passage in Slade J's judgment (which I have already set out) and observed [2004] Ch 337, 355, para 39:

"But, as indicated in *Agnew's* case, the real question was whether the rights and obligations conferred and imposed by clause 5(c) disclosed an intention that the company should be free to deal with the book debts and withdraw them from the security without the consent of the bank. Such an approach to the provisions of clause 5(c) of the debenture in the *Siebe Gorman* case must have led to the conclusion that the collection and free use of the proceeds of book debts through the ordinary operation of the bank account was not only permitted but envisaged. The inevitable consequence would be to reject the description of the transaction as a first fixed charge."

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155. It follows that the Court of Appeal, although right on the doctrine of precedent, was in my view wrong to reverse Sir Andrew Morritt V-C on the issue of substance. I respectfully think that Lord Phillips MR was wrong in the broad ground of decision which he put forward at p 383, para 94 of his judgment. It has the attraction of simplicity and certainty but it approaches an essentially practical question (can the trader continue to use his circulating capital, including any credit available under an agreed overdraft, in the ordinary course of his business?) as if it were a technical question of tracing in equity. Sir Andrew Morritt V-C was right to reject that approach, as he did in the first passage which I have quoted from his judgment. I also think that Lord Phillips MR was wrong on the narrower issue of construction which he considered a little earlier in his judgment, at p 382, para 93. I need not repeat my reasons for that conclusion.

Postscript: draftsmen's precedents and collateral transactions

156. Judges considering this area of the law have often commented on the convenience (in point of legal certainty) of using standard-form clauses, the meaning of which has already been determined by the court. For instance Knox J observed in *Ex p Copp* [1989] BCLC 13, 25:

"this is a type of transaction in respect of which judicial precedent is a particularly valuable guide to the commercial adviser. It is one of the main justifications for the doctrine of precedent that the adviser can, if he can rely on precedent, give reliable advice to his clients and it is trite law that that is a particularly cogent consideration in regard to property transactions of one sort or another."

Requirements for particulars of floating charges to be registered publicly, and for a company's register of debentures to be open for inspection, suggest that Parliament intended that the existence and scope of any floating charge should be ascertainable by the general public, at least in theory (doubts as to how the system works in practice were expressed by Lord Hoffmann in the *Cosslett* case [2002] 1 AC 336, 347-348, para 19).

157. These considerations might be thought to lead to the conclusion that everything relevant to the characterisation of a charge should be apparent on the face of the formal debenture, without further inquiry. That was, as I understand it, one of the reasons why Knox J, in *Ex p Copp*, declined to look at evidence about an agreed overdraft limit, regarding it as a "collateral arrangement". Knox J may have been right in his view that it was unnecessary to receive evidence about an overdraft limit (which may change from time to time) but he took the wrong approach as to the effect of the debenture itself, as Sir Andrew Morritt V-C rightly concluded [2004] Ch 337, 355, para 40. The form of debenture showed that the recycling of book debts was "not only permitted but envisaged" and it contained no relevant restriction on that being done in the ordinary course of business.

158. In practice banks use printed standard forms of debenture in simple cases, and City solicitors no doubt have more sophisticated forms, suitable for very large transactions, in their word-processing libraries. It is most desirable that any form of secured debenture, whether simple or complicated, should contain all the terms necessary for its correct characterisation, without resort to any side-letters or other less formal documents (as in the Australian case of *Hart v Barnes* (1982) 7 ACLR *736 310, mentioned in *Agnew's case* [2001] 2 AC 710, at para 23). But the fact is that when a bank takes a charge there will normally be at least three documents in play: the debenture creating the charge, the bank's facility letter offering a term loan or an overdraft, and the bank's general terms and conditions. Sometimes there will be more documents that are relevant. I would not rule out the possibility that in some (probably rare) cases all this documentation might have to be taken into account, in its proper commercial context, in determining whether a charge "as created" was a fixed or floating charge.

159. In one of the earliest cases on floating charges, *In re Florence Land and Public Works Co, Ex p Moor (1878) 10 Ch D 530*, 537, Sir George Jessel MR said:

"The question we have to decide must be decided, like all other questions of the kind, having regard to the surrounding circumstances under which the instrument was executed, and especially the respective positions of the parties who were the contracting parties, to carry out whose agreement that instrument was executed."

Cozens-Hardy LJ made similar observations in the *Yorkshire Woolcombers case [1903] 2 Ch 284*, 297. Many of the later cases have emphasised the need for the court to look at the commercial realities of the situation. The wish to achieve legal certainty by use of a standard precedent cannot override the need to construe any document in its commercial context.

160. It is also necessary to bear in mind Lord Millett's warning in *Agnew's case [2001] 2 AC 710*, 730, para 48, that formal provision for a blocked account is not enough "if it is not operated as one in fact". Lord Millett did not expand on this point, which may raise difficult questions as to what Staughton LJ, in *Welsh Development Agency v Export Finance Co Ltd [1992] BCLC 148*, 186-7, referred to as "external" and "internal" routes to the construction of commercial documents. This point is discussed in an article by Stephen Atherton and Rizwaan Jameel Mokal in (2005) 26 *Company Lawyer* 10, 16-18. These difficulties suggest to me that the expedient mentioned in the postscript to the judgment of the Master of the Rolls (para 99), although no doubt appropriate and efficacious in some commercial contexts, may not provide a simple solution in every case.

161. On the topic of overruling long-standing decisions which have been relied on by commercial lenders, and on the further topic of prospective overruling, I am in full and respectful agreement with the opinions of my noble and learned friends, Lord Nicholls of Birkenhead and Lord Hope. I would allow this appeal and hold, without any sort of temporal restriction, that the *Siebe Gorman* case was wrongly decided on the issue of construction.

BARONESS HALE OF RICHMOND

162. My Lords, I agree that, for the reasons given in the opinion of my noble and learned friend, Lord Scott of Foscote, supplemented by those of Lord Hope of Craighead and Lord Walker of Gestingthorpe, the debenture in this case created only a floating charge. I also agree that that part of the decision in *Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142* which dealt with the effect of the debenture in that case should be overruled with the usual retrospective effect. In common with my noble and *737 learned friend, Lord Nicholls of Birkenhead, and also Lord Hope, I would not wish to rule out the possibility that this House might one day consider that the only just result was to declare that its decision should have prospective effect only, including the possibility that this could arise in a dispute about the interpretation of a statute.

163. There is one other possibility that I would not wish to rule out. That is whether it might in future be decided that the Court of Appeal, or even the High Court, could decline to follow a previous decision of the Court of Appeal which has been expressly disapproved as part of the ratio decidendi in a case in the Judicial Committee of Privy Council on appeal from a country in which the law on the subject is the same as that in England and Wales. The Court of Appeal in *Worcester Works Finance Ltd v Cooden Engineering Co Ltd [1972] 1 QB 210* decided that it was possible. In *Davis v Johnson [1979] AC 264*, this House stated that the rule laid down in *Young v Bristol Aeroplane Co Ltd [1944] KB 718*, that with only three exceptions the Court of Appeal is bound by its own previous decisions, was still binding on the Court of Appeal, despite what Lord Diplock described, at p 325c, as the "one-man crusade" of Lord Denning to free them from its shackles. This was in the context of a much more radical departure from the exceptions allowed in the *Young* case. *Worcester Works Finance* was not cited or referred to in either the House of Lords or the Court of Appeal in *Davis v Johnson*. Privy Council decisions were not discussed in *Young*. We ourselves have heard no argument on the matter. I would hope, therefore, that nothing which is said in this appeal is taken to rule out the possibility that a further exception or qualification might exist or be developed along the lines indicated above.

164. In common with your Lordships, I would allow this appeal and make the order proposed by Lord Scott.

LORD BROWN OF EATON-UNDER-HEYWOOD

165. My Lords, I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Nicholls of Birkenhead, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give I too

would allow this appeal and make the order proposed by Lord Scott. Whilst I would not rule out the possibility that this House may one day think it right to declare the law with prospective effect only, I am quite clear that this is not the case for such an order.

Appeal allowed with costs in House of Lords and below.

Order of Sir Andrew Morritt V-C restored.

Representation

Solicitors: Acting Solicitor to HM Revenue and Customs and Treasury Solicitors ; Allen & Overy .

S H

(c) Incorporated Council of Law Reporting for England & Wales

Exhibit 10

*809 Street Respondent v Mountford Appellant



Positive/Neutral Judicial Consideration

Court

House of Lords

Judgment Date

2 May 1985

Report Citation

[1985] 2 W.L.R. 877

[1985] A.C. 809



House of Lords

Lord Scarman , Lord Keith of Kinkel , Lord Bridge of Harwich , Lord Brightman and Lord Templeman

1985 March 4, 5, 6; May 2

Licence or Tenancy—Exclusive occupation—Furnished accommodation—Occupier signing purported licence containing declaration that no tenancy created—Whether licence or tenancy

By an agreement dated 7 March 1983 S. granted M. the right to occupy two rooms for £37 per week subject to termination by 14 days' notice and subject to conditions set forth in the agreement, which was entitled 'licence agreement' and which contained a declaration signed by M. to the effect that she understood that the agreement did not give her a tenancy protected under the Rent Acts. M. and her husband *810 then moved into the rooms, of which they had exclusive occupation. In August 1983 S. sought an order in the county court declaring whether the occupancy under the agreement was a licence or a protected tenancy. The recorder held that it was a tenancy. On appeal by S. the Court of Appeal declared that M. occupied the rooms under a licence.

On appeal by M.:-

Held, allowing the appeal, that where residential accommodation had been granted for a term at a rent with exclusive possession, the grantor providing neither attendance nor services, the legal consequence was the creation of a tenancy, and that, accordingly, on its true construction, the agreement between S. and M., notwithstanding the use of the word 'licence,' had the effect of creating a tenancy (post, pp. 818C-F, 826D-E, H - 827B, F).

Murray Bull & Co. Ltd. v. Murray [1953] 1 Q.B. 211 overruled.

Aldrington Garages Ltd. v. Fielder (1978) 37 P. & C.R. 461 , C.A.; *Somma v. Hazelhurst* [1978] 1 W.L.R. 1014 , C.A. and *Sturrolson & Co. v. Weniz* (1984) 272 E.G. 326 , C.A. disapproved.

Radaich v. Smith (1959) 101 C.L.R. 209 considered.

Per curiam. Henceforth courts dealing with such cases will, save in exceptional cases, only be concerned to inquire whether as a result of an agreement relating to residential accommodation the occupier is a lodger or a tenant (post, p. 827E-F).

Decision of the Court of Appeal [1985] 49 P. & C.R. 324 reversed.

The following cases are referred to in the opinion of Lord Templeman:

Abbeyfield (Harpenden) Society Ltd. v. Woods [1968] 1 W.L.R. 374; [1968] 1 All E.R. 352, C.A.
Addiscombe Garden Estates Ltd. v. Crabbe [1958] 1 Q.B. 513; [1957] 3 W.L.R. 980; [1957] 3 All E.R. 563, C.A.
Aldrington Garages Ltd. v. Fielder (1978) 37 P. & C.R. 461, C.A.
Allan v. Liverpool Overseers (1874) L.R. 9 Q.B. 180
Booker v. Palmer [1942] 2 All E.R. 674, C.A.
Cobb v. Lane [1952] 1 T.L.R. 1037, C.A.
Errington v. Errington and Woods [1952] 1 K.B. 290; [1952] 1 All E.R. 149, C.A.
Facchini v. Bryson [1952] 1 T.L.R. 1386, C.A.
Glenwood Lumber Co. Ltd. v. Phillips [1904] A.C. 405, P.C.
Heslop v. Burns [1974] 1 W.L.R. 1241; [1974] 3 All E.R. 406, C.A.
Isaac v. Hotel de Paris Ltd. [1960] 1 W.L.R. 239; [1960] 1 All E.R. 348, P.C.
Marchant v. Charters [1977] 1 W.L.R. 1181; [1977] 3 All E.R. 918, C.A.
Marcroft Wagons Ltd. v. Smith [1951] 2 K.B. 496; [1951] 2 All E.R. 271, C.A.
Mayhew v. Suttle (1854) 4 El. & Bl. 347
Murray Bull & Co. Ltd. v. Murray [1953] 1 Q.B. 211; [1952] 2 All E.R. 1079
Radaich v. Smith (1959) 101 C.L.R. 209
Shell-Mex and B.P. Ltd. v. Manchester Garages Ltd. [1971] 1 W.L.R. 612; [1971] 1 All E.R. 841, C.A.
Smith v. Seghill Overseers (1875) L.R. 10 Q.B. 422
Somma v. Hazelhurst [1978] 1 W.L.R. 1014; [1978] 2 All E.R. 1011, C.A. *811
Sturrolson & Co. Ltd. v. Weniz (1984) 272 E.G. 326, C.A.
Taylor v. Caldwell (1863) 3 B. & S. 826

The following additional cases were cited in argument:

Bahamas International Trust Co. Ltd. v. Threadgold [1974] 1 W.L.R. 1514 ; [1974] 3 All E.R. 428 ; [1974] 3 All E.R. 881
, C.A. and *H.L.(E.)*
Demuren v. Seal Estates Ltd. (1978) 249 E.G. 440, C.A.
Matchams Park (Holdings) Ltd. v. Domett (1984) 272 E.G. 549, C.A.
O'Malley v. Seymour (1978) 250 E.G. 1083, C.A.
Torbett v. Faulkner [1952] 2 T.L.R. 659, C.A.
Verrall v. Great Yarmouth Borough Council [1981] Q.B. 202; [1980] 3 W.L.R. 258; [1980] 1 All E.R. 839 , Watkins J.
and C.A.
Wang v. Wei (1975) 237 E.G. 657

APPEAL from the Court of Appeal.

This was an appeal by the appellant, Wendy Mountford, by leave of the House of Lords from the order of the Court of Appeal (Slade and Griffiths L.JJ.) on 18 April 1984 that by an agreement dated 7 March 1983 the respondent, Roger Theodore Crispin Street, had granted a licence to occupy rooms at 5, St. Clements Gardens, Boscombe, to the appellant and not a tenancy, as held by Mr. Recorder Rolf in the Bournemouth County Court on 21 September 1983.

The facts are stated in the opinion of Lord Templeman.

John Hicks Q.C. and *Claudia Ackner* for the appellant. The following propositions are relied upon: (1) Whether or not parties enter into legal relationships at all is entirely a matter of their intention, at least where the relationship in question is contractual. (2) If a contract is entered into the factual content of the parties' respective rights and obligations thereunder is entirely a matter for them, as is the factual content of any rights gratuitously conferred in the absence of a contract, subject in either event to (i) any statute to the contrary, and (ii) the law as to illegality or any other overriding rule of law. (3) The effect of such factual rights and obligations, including the category into which, the resulting relationship falls (and in particular whether they do or

do not create a tenancy), and the consequences of that relationship, are matters of law for the court, and the parties' opinions on the subject are irrelevant.

(4) Whether a tenancy subsists therefore depends on the substantive rights and obligations of the parties and they cannot bring about a result inconsistent with those rights and obligations by their descriptions of the relationship as a tenancy or otherwise or by a term purporting to determine its category. (5) A tenancy at law has not been created unless a landlord with a sufficient legal estate in land, complying with any necessary formalities, grants the right of exclusive possession of land, having the power to do so, to a person or persons capable of holding as a tenant, for a term which is a 'term of years absolute' for the purposes of the [Law of Property Act 1925](#). (6) The grant under a contract of a right to enter and take exclusive possession of land for a fixed or periodic term in consideration of periodic payments creates a tenancy unless the requirements of proposition (5) are not fulfilled or the possession is that of a service occupier or otherwise as agent for the *812 grantor. (7) If there are any exceptions to proposition (6) they are particular exceptions as from time to time recognised by the courts and do not include any general exception based on a consideration of circumstances at large. (8) If propositions (6) and (7) are incorrect, nevertheless the circumstances described in proposition (6) are a very strong indication that a tenancy has been created, to be displaced only in special and unusual cases. (9) A document purporting to contain an agreement must be disregarded if and to the extent that it does not truly represent or reproduce the nature of the real transaction between the parties. For proposition (6), which is crucial to the primary submission being made, reliance is placed on [Glenwood Lumber Co. Ltd. v. Phillips \[1904\] A.C. 405](#) and [Radaich v. Smith \(1959\) 101 C.L.R. 209](#). For proposition (8), which is an alternative submission, reliance is placed on [Addiscombe Garden Estates Ltd. v. Crabbe \[1958\] 1 Q.B. 513](#). In the further alternative, under proposition (9), [Wang v. Wei \(1975\) 237 E.G. 657](#) is an example of the doctrine that extrinsic evidence is admissible to prove the true nature of an agreement even though it may vary or add to the written instrument.

William Goodhart Q.C. and *Peter Cowell* for the respondent. (1) The expression 'exclusive possession' or 'exclusive occupation' can be used in two senses, namely (a) as meaning no more than the right of a contractual occupier to prevent, through the grant of an injunction, the owner of the land entering on the land for purposes inconsistent with the contract or (b) in the full sense of the right enjoyed by the owner of an estate in land in possession to exclude all the world. (2) It is a matter for the intention of the parties whether the contract confers on the occupier exclusive possession in the limited sense (i.e. a licence) or the full sense (i.e. a tenancy). (3) There are many factors which may be taken into account in deciding which form of 'exclusive possession' is conferred on the occupier. Where no 'rent' is payable, a licence is strongly indicated. Where the occupier is given rights of occupation which are not terminable for a considerable time, a tenancy is indicated because the contractual rights of the occupier will be of little value if they cannot be enforced against the owner's successor in title.

(4) The form of the agreement is a material matter. The label attached by the parties is not conclusive and will not be applied if it is inconsistent with the other terms of the agreement. The label is, however, a material factor where the other terms of the agreement are not conclusive one way or the other or where the terms are not fully spelt out.

(5) The distinction drawn in proposition (1) is applicable to *all* contracts to occupy land. The *motive* of the owner is irrelevant. Given that it is possible to grant a limited 'personal' right of exclusive occupation, it matters not whether the grantor is acting out of generosity or for commercial reasons. (6) If the Rent Acts did not exist, there would be no reason to deny the existence of freedom of contract in any case to choose between a grant of a personal right of occupation and a grant of a legal estate in land. The argument for the appellant is in truth only that because freedom of contract *ought* not to exist in certain cases *813 it *does* not exist in such cases. This is a non-sequitur. (7) The appellant has not alleged and could not successfully allege that the use of a 'licence' agreement is contrary to public policy. Accordingly it is not necessary to consider the question of freedom of contract driving a 'coach and horses' through the Rent Acts. In any event, Parliament has, where it thought fit, brought licences within the rent control legislation, e.g. the [Agricultural Holdings Act 1948](#) and the [Housing Act 1980](#). [Reference was made to [Verrall v. Great Yarmouth Borough Council \[1981\] Q.B. 202](#), 215-216.] There is a whole line of cases where it has been held that a licence and not a tenancy has been created despite the fact of exclusive occupation being vested in the occupier: [Marcroft Wagons Ltd. v. Smith \[1951\] 2 K.B. 496](#); [Errington v. Errington and Woods \[1952\] 1 K.B. 290](#); [Cobb v. Lane \[1952\] 1 T.L.R. 1037](#); [Torbett v. Faulkner \[1952\] 2 T.L.R. 659](#); [Isaac v. Hotel de Paris Ltd. \[1960\] 1 W.L.R. 239](#); [Abbeyfield \(Harpenden\) Society Ltd. v. Woods \[1968\] 1 W.L.R. 374](#); [Shell-Mex and B.P. Ltd. v. Manchester Garages Ltd. \[1971\] 1 W.L.R. 612](#); [Marchant v. Charters \[1977\] 1 W.L.R. 1181](#); [Somma v. Hazelhurst \[1978\] 1 W.L.R. 1014](#); [Aldrington Garages Ltd. v. Fielder \(1978\) 37 P. & C.R. 461](#) and [Matchams Park \(Holdings\) Ltd. v. Domett \(1984\) 272 E.G. 549](#). The whole current of authority has been to emphasise that it is the intention of the parties that is to be looked at. It should also be added that a licence agreement can confer exclusive or non-exclusive occupation, as seen in [Bahamas International Trust Co. Ltd. v. Threadgold \[1974\] 1 W.L.R. 1514](#).

The Court of Appeal were correct in holding that the intention of the parties is the paramount or decisive consideration and they correctly construed the agreement, both in respect of its terms and the statement of intention therein contained, as conferring a licence upon the appellant.

Hicks Q.C. in reply. There is a difference between agreeing the terms of an agreement and agreeing the legal consequences of it. That line is drawn in the present case between the ten numbered clauses of the agreement on the one hand, and the appended declaration by the appellant that the agreement did not give her a tenancy protected by the Rent Acts on the other. In any event, there clearly cannot be any contracting out of the provisions of the Rent Acts. In *Facchini v. Bryson* [1952] 1 T.L.R. 1386, 1389, Denning L.J. observed: 'In all the cases where an occupier has been held to be a licensee there has been something in the circumstances, such as a family arrangement, an act of friendship or generosity, or such like, to negative any intention to create a tenancy.' No such factor is present in the instant case. *Murray Bull & Co. Ltd. v. Murray* [1953] 1 Q.B. 211 was wrongly decided. The remaining cases relied upon by the respondent were all, upon analysis, cases where there was lack of intention to create legal relations, or gratuitous permission, or lack of exclusive possession (including cases of lodgers), or a holding over on unresolved terms, or a service occupancy, or they were for other reasons not within the appellant's proposition (b). [The cases were dealt with seriatim and reference was also made to *O'Malley v. Seymour* (1978) 250 E.G. 1083 and *Demuren v. Seal Estates Ltd.* (1978) 249 E.G. 440.]

***814**

Their Lordships took time for consideration.

2 May.

LORD SCARMAN.

My Lords, I have had the advantage of reading in draft the speech to be delivered by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons he gives I would allow the appeal with costs here and below

LORD KEITH OF KINKEL.

My Lords, for the reasons given in the speech of my noble and learned friend, Lord Templeman, with which I agree, I too would allow the appeal.

LORD BRIDGE OF HARWICH.

My Lords, for the reasons given in the speech of my noble and learned friend Lord Templeman, with which I agree, I would allow this appeal.

LORD BRIGHTMAN.

My Lords, I agree that this appeal should be allowed for the reasons given by my noble and learned friend, Lord Templeman.

LORD TEMPLEMAN.

My Lords, by an agreement dated 7 March 1983, the respondent Mr. Street granted the appellant Mrs. Mountford the right to occupy the furnished rooms numbers 5 and 6 at 5, St. Clements Gardens, Boscombe, from 7 March 1983 for £37 per week, subject to termination by 14 days' written notice and subject to the conditions set forth in the agreement. The question raised by this appeal is whether the agreement created a tenancy or a licence.

A tenancy is a term of years absolute. This expression, by [section 205\(1\)\(xxvii\) of the Law of Property Act 1925](#), reproducing the common law, includes a term from week to week in possession at a rent and liable to determination by notice or re-entry. Originally a term of years was not an estate in land, the lessee having merely a personal action against his lessor. But a legal estate in leaseholds was created by the Statute of Gloucester 1278 and the Act of 1529 21 Hen. VIII, c. 15. Now by [section 1 of the Law of Property Act 1925](#) a term of years absolute is an estate in land capable of subsisting as a legal estate. In the

present case if the agreement dated 7 March 1983 created a tenancy, Mrs. Mountford having entered into possession and made weekly payments acquired a legal estate in land. If the agreement is a tenancy, the occupation of Mrs. Mountford is protected by the Rent Acts.

A licence in connection with land while entitling the licensee to use the land for the purposes authorised by the licence does not create an estate in the land. If the agreement dated 7 March 1983 created a licence for Mrs. Mountford to occupy the premises, she did not acquire any estate in the land. If the agreement is a licence then Mrs. Mountford's right of occupation is not protected by the Rent Acts. Hence the practical importance of distinguishing between a tenancy and a licence.

In the course of argument, nearly every clause of the agreement dated 7 March 1983 was relied upon by the appellant as indicating a lease and by the respondent as indicating a licence. The agreement, in full, was in these terms: *815

'I Mrs. Wendy Mountford agree to take from the owner Roger Street the single furnished room number 5 and 6 at 5 St. Clements Gardens, Boscombe, Bournemouth, commencing 7 March 1983 at a licence fee of £37 per week.

'I understand that the right to occupy the above room is conditional on the strict observance of the following rules:

'1. No paraffin stoves, or other than the supplied form of heating, is allowed in the room.

'2. No one but the above-named person may occupy or sleep in the room without prior permission, and this personal licence is not assignable.

'3. The owner (or his agent) has the right at all times to enter the room to inspect its condition, read and collect money from meters, carry out maintenance works, install or replace furniture or for any other reasonable purpose.

'4. All rooms must be kept in a clean and tidy condition.

'5. All damage and breakages must be paid for or replaced at once. An initial deposit equivalent to 2 weeks' licence fee will be refunded on termination of the licence subject to deduction for all damage or other breakages or arrears of licence fee, or retention towards the cost of any necessary possession proceedings.

'6. No nuisance or annoyance to be caused to the other occupiers. In particular, all music played after midnight to be kept low so as not to disturb occupiers of other rooms.

'7. No children or pets allowed under any circumstances whatsoever.

'8. Prompt payment of the licence fee must be made every Monday in advance without fail.

'9. If the licence fee or any part of it shall be seven days in arrear or if the occupier shall be in breach of any of the other terms of this agreement or if (except by arrangement) the room is left vacant or unoccupied, the owner may re-enter the room and this licence shall then immediately be terminated (without prejudice to all other rights and remedies of the owner).

'10. This licence may be terminated by 14 days' written notice given to the occupier at any time by the owner or his agent, or by the same notice by the occupier to the owner or his agent.

'Occupier's signature

'Owner/agent's signature

'Date 7 March 1983

'I understand and accept that a licence in the above form does not and is not intended to give me a tenancy protected under the Rent Acts.

'Occupier's signature.'

On 12 August 1983 on Mrs. Mountford's application a fair rent was registered. Mr. Street then made application under section 51(a) of the County Courts Act 1959 for a declaration that Mrs. Mountford's occupancy was a licence and not a tenancy. The recorder in the county court held that Mrs. Mountford was a tenant entitled to the protection *816 of the Rent Acts and made a declaration accordingly. The Court of Appeal held that Mrs. Mountford was a licensee not entitled to the protection of the Rent Acts. Mrs. Mountford appeals.

On behalf of Mrs. Mountford her counsel, Mr. Hicks Q.C., seeks to reaffirm and re-establish the traditional view that an occupier of land for a term at a rent is a tenant providing the occupier is granted exclusive possession. It is conceded on behalf of Mr. Street that the agreement dated 7 March 1983 granted exclusive possession to Mrs. Mountford. The traditional view that the grant of exclusive possession for a term at a rent creates a tenancy is consistent with the elevation of a tenancy into an estate in land. The tenant possessing exclusive possession is able to exercise the rights of an owner of land, which is in the real sense his land albeit temporarily and subject to certain restrictions. A tenant armed with exclusive possession can keep out strangers and keep out the landlord unless the landlord is exercising limited rights reserved to him by the tenancy agreement to enter and view and repair. A licensee lacking exclusive possession can in no sense call the land his own and cannot be said to own any estate in the land. The licence does not create an estate in the land to which it relates but only makes an act lawful which would otherwise be unlawful.

On behalf of Mr. Street his counsel, Mr. Goodhart Q.C., relies on recent authorities which, he submits, demonstrate that an occupier granted exclusive possession for a term at a rent may nevertheless be a licensee if, in the words of Slade L.J. in the present case [1985] 49 P. & C.R. 324, 332:

'there is manifested the clear intention of both parties that the rights granted are to be merely those of a personal right of occupation and not those of a tenant.'

In the present case, it is submitted, the provisions of the agreement dated 7 March 1983 and in particular clauses 2, 4, 7 and 9 and the express declaration at the foot of the agreement manifest the clear intention of both parties that the rights granted are to be those of a personal nature and not those of a tenant.

My Lords, there is no doubt that the traditional distinction between a tenancy and a licence of land lay in the grant of land for a term at a rent with exclusive possession. In some cases it was not clear at first sight whether exclusive possession was in fact granted. For example, an owner of land could grant a licence to cut and remove standing timber. Alternatively the owner could grant a tenancy of the land with the right to cut and remove standing timber during the term of the tenancy. The grant of rights relating to standing timber therefore required careful consideration in order to decide whether the grant conferred exclusive possession of the land for a term at a rent and was therefore a tenancy or whether it merely conferred a bare licence to remove the timber.

In *Glenwood Lumber Co. Ltd. v. Phillips* [1904] A.C. 405, the Crown in exercise of statutory powers 'licensed' the respondents to hold an area of land for the purpose of cutting and removing timber for the term of 21 years at an annual rent. Delivering the advice of the *817 Judicial Committee of the Privy Council, Lord Davey said, at pp. 408-409:

'The appellants contended that this instrument conferred only a licence to cut timber and carry it away, and did not give the respondent any right of occupation or interest in the land itself. Having regard to the provisions of the Act under the powers of which it was executed and to the language of the document itself, their Lordships cannot adopt this view of the construction or effect of it. In the so-called licence itself it is called indifferently a licence and a demise, but in the Act it is spoken of as a lease, and the holder of it is described as the lessee. It is not, however, a question of words but of substance. If the effect of the instrument is to give the holder an exclusive right of occupation of the land, though subject to certain reservations or to a restriction of the purposes for which it may be used, it is in law a demise of the land itself. By [the Act] it is enacted that the lease shall vest in the lessee the right to take and keep exclusive possession of the lands described therein subject to the conditions in the Act provided or referred to, and the lessee is empowered (amongst other things) to bring any actions or suits against any party unlawfully in possession of any land so leased, and to prosecute all trespassers thereon. The operative part and habendum in the licence is framed in apt language to carry out the intention so expressed in the Act. and their Lordships have no doubt that the effect of the so-called licence was to confer a title to the land itself on the respondent.'

This was a case in which the court after careful consideration of the purposes of the grant, the terms of the grant and the surrounding circumstances, came to the conclusion that the grant conferred exclusive possession and was therefore a tenancy.

A contrary conclusion was reached in *Taylor v. Caldwell* (1863) 3 B. & S. 826 in which the defendant agreed to let the plaintiff have the use of the Surrey Gardens and Music Hall on four specified days giving a series of four concerts and day and night fetes at the gardens and hall on those days, and the plaintiff agreed to take the gardens and the hall and to pay £100 for each day. Blackburn J. said, at p. 832:

'The parties inaccurately call this a 'letting,' and the money to be paid a 'rent,' but the whole agreement is such as to show that the defendants were to retain the possession of the hall and gardens so that there was to be no demise of them, and that the contract was merely to give the plaintiffs the use of them on those days.'

That was a case where the court after considering the purpose of the grant, the terms of the grant and the surrounding circumstances came to the conclusion that the grantee was not entitled to exclusive possession but only to use the land for limited purposes and was therefore a licensee.

In the case of residential accommodation there is no difficulty in deciding whether the grant confers exclusive possession. An occupier of residential accommodation at a rent for a term is either a lodger or a *818 tenant. The occupier is a lodger if the landlord provides attendance or services which require the landlord or his servants to exercise unrestricted access to and use of the premises. A lodger is entitled to live in the premises but cannot call the place his own. In *Allan v. Liverpool Overseers* (1874) L.R. 9 Q.B. 180, 191-192 Blackburn J. said:

'A lodger in a house, although he has the exclusive use of rooms in the house, in the sense that nobody else is to be there, and though his goods are stowed there, yet he is not in exclusive occupation in that sense, because the landlord is there for the purpose of being able, as landlords commonly do in the case of lodgings, to have his own servants to look after the house and the furniture, and has retained to himself the occupation, though he has agreed to give the exclusive enjoyment of the occupation to the lodger.'

If on the other hand residential accommodation is granted for a term at a rent with exclusive possession, the landlord providing neither attendance nor services, the grant is a tenancy; any express reservation to the landlord of limited rights to enter and view the state of the premises and to repair and maintain the premises only serves to emphasise the fact that the grantee is entitled to exclusive possession and is a tenant. In the present case it is conceded that Mrs. Mountford is entitled to exclusive possession and is not a lodger. Mr. Street provided neither attendance nor services and only reserved the limited rights of inspection and maintenance and the like set forth in clause 3 of the agreement. On the traditional view of the matter, Mrs. Mountford not being a lodger must be a tenant.

There can be no tenancy unless the occupier enjoys exclusive possession; but an occupier who enjoys exclusive possession is not necessarily a tenant. He may be owner in fee simple, a trespasser, a mortgagee in possession, an object of charity or a service occupier. To constitute a tenancy the occupier must be granted exclusive possession for a fixed or periodic term certain in consideration of a premium or periodical payments. The grant may be express, or may be inferred where the owner accepts weekly or other periodical payments from the occupier.

Occupation by service occupier may be eliminated. A service occupier is a servant who occupies his master's premises in order to perform his duties as a servant. In those circumstances the possession and occupation of the servant is treated as the possession and occupation of the master and the relationship of landlord and tenant is not created; see *Mayhew v. Suttle* (1854) 4 El. & Bl. 347. The test is whether the servant requires the premises he occupies in order the better to perform his duties as a servant:

'Where the occupation is necessary for the performance of services, and the occupier is required to reside in the house in order to perform those services, the occupation being strictly ancillary to the performance of the duties which the occupier has to perform, the occupation is that of a servant'; per Mellor J. in *Smith v. Seghill Overseers* (1875) L.R. 10 Q.B. 422, 428.

*819

The cases on which Mr. Goodhart relies begin with *Booker v. Palmer* [1942] 2 All E.R. 674. The owner of a cottage agreed to allow a friend to install an evacuee in the cottage rent free for the duration of the war. The Court of Appeal held that there was no intention on the part of the owner to enter into legal relationships with the evacuee. Lord Greene M.R., said, at p. 677:

'To suggest there is an intention there to create a relationship of landlord and tenant appears to me to be quite impossible. There is one golden rule which is of very general application, namely, that the law does not impute intention to enter into legal relationships where the circumstances and the conduct of the parties negative any intention of the kind. It seems to me that this is a clear example of the application of that rule.'

The observations of Lord Greene M. R. were not directed to the distinction between a contractual tenancy and a contractual licence. The conduct of the parties (not their professed intentions) indicated that they did not intend to contract at all.

In the present case, the agreement dated 7 March 1983 professed an intention by both parties to create a licence and their belief that they had in fact created a licence. It was submitted on behalf of Mr. Street that the court cannot in these circumstances decide that the agreement created a tenancy without interfering with the freedom of contract enjoyed by both parties. My Lords, Mr. Street enjoyed freedom to offer Mrs. Mountford the right to occupy the rooms comprised in the agreement on such lawful terms as Mr. Street pleased. Mrs. Mountford enjoyed freedom to negotiate with Mr. Street to obtain different terms. Both parties enjoyed freedom to contract or not to contract and both parties exercised that freedom by contracting on the terms set forth in the written agreement and on no other terms. But the consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence. The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.

It was also submitted that in deciding whether the agreement created a tenancy or a licence, the court should ignore the Rent Acts. If Mr. Street has succeeded, where owners have failed these past 70 years, in driving a coach and horses through the Rent Acts, he must be left to enjoy the benefit of his ingenuity unless and until Parliament intervenes. I accept that the Rent Acts are irrelevant to the problem of determining the legal effect of the rights granted by the agreement. Like the professed intention of the parties, the Rent Acts cannot alter the effect of the agreement.

In *Marcroft Wagons Ltd. v. Smith* [1951] 2 K.B. 496 the daughter of a deceased tenant who lived with her mother claimed to be a statutory tenant by succession and the landlords asserted that the daughter had no *820 rights under the Rent Acts and was a trespasser. The landlords expressly refused to accept the daughter's claims but accepted rent from her while they were considering the position. If the landlords had decided not to apply to the court for possession but to accept the daughter as a tenant, the moneys paid by the daughter would have been treated as rent. If the landlords decided, as they did decide, to apply for possession and to prove, as they did prove, that the daughter was not a statutory tenant, the moneys paid by the daughter were treated as mesne profits. The Court of Appeal held with some hesitation that the landlords never accepted the daughter as tenant and never intended to contract with her although the landlords delayed for some six months before applying to the court for possession. Roxburgh J. said, at p. 507:

'Generally speaking, when a person, having a sufficient estate in land, lets another into exclusive possession, a tenancy results, and there is no question of a licence. But the inference of a tenancy is not necessarily to be drawn where a person succeeds on a death to occupation of rent-controlled premises and a landlord accepts some rent while he or the occupant, or both of them, is or are considering his or their position. If this is all that happened in this case, then no tenancy would result.'

In that case, as in *Booker v. Palmer* the court deduced from the conduct of the parties that they did not intend to contract at all.

Errington v. Errington and Woods [1952] 1 K.B. 290 concerned a contract by a father to allow his son to buy the father's house on payment of the instalments of the father's building society loan. Denning L.J. referred, at p. 297, to the judgment of Lord Greene M.R. in *Booker v. Palmer* [1942] 2 All E.R. 674, 677 where, however, the circumstances and the conduct of the parties negated any intention to enter into legal relationships. Denning L.J. continued, at pp. 297-298:

'We have had many instances lately of occupiers in exclusive possession who have been held to be not tenants, but only licensees. When a requisitioning authority allowed people into possession at a weekly rent: ... when a landlord told a tenant on his retirement that he could live in a cottage rent free for the rest of his days: ... when a landlord, on the death of the widow of a statutory tenant, allowed her daughter to remain in possession, paying rent for six months: *Marcroft Wagons Ltd. v. Smith* [1951] 2 K.B. 496 ; when the owner of a shop allowed the manager to live in a flat above the shop, but did not require him to do so, and the value of the flat was taken into account at £1 a week in fixing his wages: ... in each of those cases the occupier was held to be a licensee and not a tenant. ... The result of all these cases is that, although a person who is let into exclusive possession is prima facie to be considered a tenant, nevertheless he will not be held to be so if the circumstances negative any intention to create a tenancy. Words alone may not suffice. Parties cannot turn a tenancy into a licence merely by calling it one. But if the circumstances and the conduct of the parties show that all that was intended was that the occupier *821 should be granted a personal privilege, with no interest in the land, he will be held to be a licensee only.'

In *Errington v. Errington and Woods* [1952] 1 K.B. 290 and in the cases cited by Denning L.J. at p. 297 there were exceptional circumstances which negated the prima facie intention to create a tenancy, notwithstanding that the occupier enjoyed exclusive occupation. The intention to create a tenancy was negated if the parties did not intend to enter into legal relationships at all, or where the relationship between the parties was that of vendor and purchaser, master and service occupier, or where the owner, a requisitioning authority, had no power to grant a tenancy. These exceptional circumstances are not to be found in the present case where there has been the lawful, independent and voluntary grant of exclusive possession for a term at a rent.

If the observations of Denning L.J. are applied to the facts of the present case it may fairly be said that the circumstances negative any intention to create a mere licence. Words alone do not suffice. Parties cannot turn a tenancy into a licence merely by calling it one. The circumstances and the conduct of the parties show that what was intended was that the occupier should be granted exclusive possession at a rent for a term with a corresponding interest in the land which created a tenancy.

In *Cobb v. Lane* [1952] 1 T.L.R. 1037 , an owner allowed her brother to occupy a house rent free. The county court judge, who was upheld by the Court of Appeal, held that there was no intention to create any legal relationship and that a tenancy at will was not to be implied. This is another example of conduct which negatives any intention of entering into a contract, and does not assist in distinguishing a contractual tenancy from a contractual licence.

In *Facchini v. Bryson* [1952] 1 T.L.R. 1386 , an employer and his assistant entered into an agreement which, inter alia, allowed the assistant to occupy a house for a weekly payment on terms which conferred exclusive possession. The assistant did not occupy the house for the better performance of his duty and was not therefore a service occupier. The agreement stipulated that 'nothing in this agreement shall be construed to create a tenancy between the employer and the assistant.' Somervell L.J. said, at p. 1389:

'If, looking at the operative clauses in the agreement, one comes to the conclusion that the rights of the occupier, to use a neutral word, are those of a lessee, the parties cannot turn it into a licence by saying at the end 'this is deemed to be a licence;' nor can they, if the operative paragraphs show that it is merely a licence, say that it should be deemed to be a lease.'

Denning L.J. referred to several cases including *Errington v. Errington and Woods* and *Cobb v. Lane* and said, at pp. 1389-1390:

'In all the cases where an occupier has been held to be a licensee there has been something in the circumstances, such as a family arrangement, an act of friendship or generosity, or such like, to negative any intention to create a tenancy. ... In the present case, *822 however, there are no special circumstances. It is a simple case where the employer let a man into occupation of a house in consequence of his employment at a weekly sum payable by him. The occupation has all the features of a service tenancy, and the parties cannot by the mere words of their contract turn it into something else. Their relationship is determined by the law and not by the label which they choose to put on it: ...'

The decision, which was thereafter binding on the Court of Appeal and on all lower courts, referred to the special circumstances which are capable of negating an intention to create a tenancy and reaffirmed the principle that the professed intentions

of the parties are irrelevant. The decision also indicated that in a simple case a grant of exclusive possession of residential accommodation for a weekly sum creates a tenancy.

In *Murray Bull & Co. Ltd. v. Murray* [1953] 1 Q.B. 211 a contractual tenant held over, paying rent quarterly. McNair J. found, at p. 217:

'both parties intended that the relationship should be that of licensee and no more ... The primary consideration on both sides was that the defendant, as occupant of the flat, should not be a controlled tenant.'

In my opinion this case was wrongly decided. McNair J. citing the observations of Denning L.J. in *Errington v. Errington and Woods* [1952] 1 K.B. 290, 297 and *Marcroft Wagons Ltd. v. Smith* [1951] 2 K.B. 496 failed to distinguish between first, conduct which negatives an intention to create legal relationships, secondly, special circumstances which prevent exclusive occupation from creating a tenancy and thirdly, the professed intention of the parties. In *Murray Bull & Co. Ltd. v. Murray* the conduct of the parties showed an intention to contract and there were no relevant special circumstances. The tenant holding over continued by agreement to enjoy exclusive possession and to pay a rent for a term certain. In those circumstances he continued to be a tenant notwithstanding the professed intention of the parties to create a licence and their desire to avoid a controlled tenancy.

In *Addiscombe Garden Estates Ltd. v. Crabbe* [1958] 1 Q.B. 513 the Court of Appeal considered an agreement relating to a tennis club carried on in the grounds of a hotel. The agreement was:

'described by the parties as a licence ... the draftsman has studiously and successfully avoided the use either of the word 'landlord' or the word 'tenant' throughout the document' *per* Jenkins L.J. at p. 522.

On analysis of the whole of the agreement the Court of Appeal came to the conclusion that the agreement conferred exclusive possession and thus created a tenancy. Jenkins L.J. said, at p. 522:

'The whole of the document must be looked at; and if, after it has been examined, the right conclusion appears to be that, whatever label may have been attached to it, it in fact conferred and imposed on the grantee in substance the rights and obligations of a tenant, *823 and on the grantor in substance the rights and obligations of a landlord, then it must be given the appropriate effect, that is to say, it must be treated as a tenancy agreement as distinct from a mere licence.'

In the agreement in the *Addiscombe* case it was by no means clear until the whole of the document had been narrowly examined that exclusive possession was granted by the agreement. In the present case it is clear that exclusive possession was granted and so much is conceded. In these circumstances it is unnecessary to analyse minutely the detailed rights and obligations contained in the agreement.

In the *Addiscombe* case Jenkins L.J. referred, at p. 528, to the observations of Denning L.J. in *Errington and Errington and Woods* to the effect that 'The test of exclusive possession is by no means decisive.' Jenkins L.J. continued:

'I think that wide statement must be treated as qualified by his observations in *Facchini v. Bryson* [1952] 1 T.L.R. 1386, 1389; and it seems to me that, save in exceptional cases of the kind mentioned by Denning L.J. in that case, the law remains that the fact of exclusive possession, if not decisive against the view that there is a mere licence, as distinct from a tenancy, is at all events a consideration of the first importance.'

Exclusive possession is of first importance in considering whether an occupier is a tenant; exclusive possession is not decisive because an occupier who enjoys exclusive possession is not necessarily a tenant. The occupier may be a lodger or service occupier or fall within the other exceptional categories mentioned by Denning L.J. in *Errington v. Errington and Woods* [1952] 1 K.B. 290.

In *Isaac v. Hotel de Paris Ltd.* [1960] 1 W.L.R. 239 an employee who managed a night bar in a hotel for his employer company which held a lease of the hotel negotiated 'subject to contract' to complete the purchase of shares in the company and to be allowed to run the nightclub for his own benefit if he paid the head rent payable by the company for the hotel. In the expectation that the negotiations 'subject to contract' would ripen into a binding agreement, the employee was allowed to run the nightclub

and he paid the company's rent. When negotiations broke down the employee claimed unsuccessfully to be a tenant of the hotel company. The circumstances in which the employee was allowed to occupy the premises showed that the hotel company never intended to accept him as a tenant and that he was fully aware of that fact. This was a case, consistent with the authorities cited by Lord Denning in giving the advice of the Judicial Committee of the Privy Council, in which the parties did not intend to enter into contractual relationships unless and until the negotiations 'subject to contract' were replaced by a binding contract.

In *Abbeyfield (Harpenden) Society Ltd. v. Woods* [1968] 1 W.L.R. 374 the occupier of a room in an old people's home was held to be a licensee and not a tenant. Lord Denning M.R. said, at p. 376:

'The modern cases show that a man may be a licensee even though he has exclusive possession, even though the word 'rent' is used, *824 and even though the word 'tenancy' is used. The court must look at the agreement as a whole and see whether a tenancy really was intended. In this case there is, besides the one room, the provision of services, meals, a resident housekeeper, and such like. The whole arrangement was so personal in nature that the proper inference is that he was a licensee.'

As I understand the decision in the *Abbeyfield* case the court came to the conclusion that the occupier was a lodger and was therefore a licensee, not a tenant.

In *Shell-Mex and B. P. Ltd. v. Manchester Garages Ltd.* [1971] 1 W.L.R. 612 the Court of Appeal after carefully examining an agreement whereby the defendant was allowed to use a petrol company's filling station for the purposes of selling petrol, came to the conclusion that the agreement did not grant exclusive possession to the defendant who was therefore a licensee. At p. 615 Lord Denning M.R. in considering whether the transaction was a licence or a tenancy said:

'Broadly speaking, we have to see whether it is a personal privilege given to a person (in which case it is a licence), or whether it grants an interest in land (in which case it is a tenancy). At one time it used to be thought that exclusive possession was a decisive factor. But that is not so. It depends on broader considerations altogether. Primarily on whether it is personal in its nature or not: see *Errington v. Errington and Woods* [1952] 1 K.B. 290.'

In my opinion the agreement was only 'personal in its nature' and created 'a personal privilege' if the agreement did not confer the right to exclusive possession of the filling station. No other test for distinguishing between a contractual tenancy and a contractual licence appears to be understandable or workable.

Heslop v. Burns [1974] 1 W.L.R. 1241 was another case in which the owner of a cottage allowed a family to live in the cottage rent free and it was held that no tenancy at will had been created on the ground that the parties did not intend any legal relationship. Scarman L.J. cited with approval, at p. 1252, the statement by Denning L.J. in *Facchini v. Bryson* [1952] 1 T.L.R. 1386, 1389:

'In all the cases where an occupier has been held to be a licensee there has been something in the circumstances, such as a family arrangement, an act of friendship or generosity, or such like, to negative any intention to create a tenancy.'

In *Marchant v. Charters* [1977] 1 W.L.R. 1181 a bedsitting room was occupied on terms that the landlord cleaned the rooms daily and provided clean linen each week. It was held by the Court of Appeal that the occupier was a licensee and not a tenant. The decision in the case is sustainable on the grounds that the occupier was a lodger and did not enjoy exclusive possession. But Lord Denning M.R. said, at p. 1185:

'What is the test to see whether the occupier of one room in a house is a tenant or a licensee? It does not depend on whether he or she has exclusive possession or not. It does not depend on *825 whether the room is furnished or not. It does not depend on whether the occupation is permanent or temporary. It does not depend on the label which the parties put upon it. All these are factors which may influence the decision but none of them is conclusive. All the circumstances have to be worked out. Eventually the answer depends on the nature and quality of the occupancy. Was it intended that the occupier should have a stake in the room or did he have only permission for himself personally to occupy the room, whether under a contract or not? In which case he is a licensee.'

But in my opinion in order to ascertain the nature and quality of the occupancy and to see whether the occupier has or has not a stake in the room or only permission for himself personally to occupy, the court must decide whether upon its true construction the agreement confers on the occupier exclusive possession. If exclusive possession at a rent for a term does not constitute a tenancy then the distinction between a contractual tenancy and a contractual licence of land becomes wholly unidentifiable.

In *Somma v. Hazelhurst* [1978] 1 W.L.R. 1014, a young unmarried couple H. and S. occupied a double bedsitting room for which they paid a weekly rent. The landlord did not provide services or attendance and the couple were not lodgers but tenants enjoying exclusive possession. But the Court of Appeal did not ask themselves whether H. and S. were lodgers or tenants and did not draw the correct conclusion from the fact that H. and S. enjoyed exclusive possession. The Court of Appeal were diverted from the correct inquiries by the fact that the landlord obliged H. and S. to enter into separate agreements and reserved power to determine each agreement separately. The landlord also insisted that the room should not in form be let to either H. or S. or to both H. and S. but that each should sign an agreement to share the room in common with such other persons as the landlord might from time to time nominate. The sham nature of this obligation would have been only slightly more obvious if H. and S. had been married or if the room had been furnished with a double bed instead of two single beds. If the landlord had served notice on H. to leave and had required S. to share the room with a strange man, the notice would only have been a disguised notice to quit on both H. and S. The room was let and taken as residential accommodation with exclusive possession in order that H. and S. might live together in undisturbed quasi-conubial bliss making weekly payments. The agreements signed by H. and S. constituted the grant to H. and S. jointly of exclusive possession at a rent for a term for the purposes for which the room was taken and the agreement therefore created a tenancy. Although the Rent Acts must not be allowed to alter or influence the construction of an agreement, the court should, in my opinion, be astute to detect and frustrate sham devices and artificial transactions whose only object is to disguise the grant of a tenancy and to evade the Rent Acts. I would disapprove of the decision in this case that H. and S. were only licensees and for the same reason would *826 disapprove of the decision in *Aldrington Garages Ltd. v. Fielder* (1978) 37 P. & C.R. 461 and *Sturolson & Co. v. Weniz* (1984) 272 E.G. 326.

In the present case the Court of Appeal, 49 P. & C.R. 324 held that the agreement dated 7 March 1983 only created a licence. Slade L.J., at p. 329 accepted that the agreement and in particular clause 3 of the agreement 'shows that the right to occupy the premises conferred on the defendant was intended as an exclusive right of occupation, in that it was thought necessary to give a special and express power to the plaintiff to enter. ...' Before your Lordships it was conceded that the agreement conferred the right of exclusive possession on Mrs. Mountford. Even without clause 3 the result would have been the same. By the agreement Mrs. Mountford was granted the right to occupy residential accommodation. The landlord did not provide any services or attendance. It was plain that Mrs. Mountford was not a lodger. Slade L.J. proceeded to analyse all the provisions of the agreement, not for the purpose of deciding whether his finding of exclusive possession was correct, but for the purpose of assigning some of the provisions of the agreement to the category of terms which he thought are usually to be found in a tenancy agreement and of assigning other provisions to the category of terms which he thought are usually to be found in a licence. Slade L.J. may or may not have been right that in a letting of a furnished room it was 'most unusual to find a provision in a tenancy agreement obliging the tenant to keep his rooms in a 'tidy condition" (p. 329). If Slade L.J. was right about this and other provisions there is still no logical method of evaluating the results of his survey. Slade L.J. reached the conclusion that 'the agreement bears all the hallmarks of a licence rather than a tenancy save for the one important feature of exclusive occupation': p. 329. But in addition to the hallmark of exclusive occupation of residential accommodation there were the hallmarks of weekly payments for a periodical term. Unless these three hallmarks are decisive, it really becomes impossible to distinguish a contractual tenancy from a contractual licence save by reference to the professed intention of the parties or by the judge awarding marks for drafting. Slade L.J. was finally impressed by the statement at the foot of the agreement by Mrs. Mountford 'I understand and accept that a licence in the above form does not and is not intended to give me a tenancy protected under the Rent Acts.' Slade L.J. said, at p. 330:

'it seems to me that, if the defendant is to displace the express statement of intention embodied in the declaration, she must show that the declaration was either a deliberate sham or at least an inaccurate statement of what was the true substance of the real transaction agreed between the parties; ...'

My Lords, the only intention which is relevant is the intention demonstrated by the agreement to grant exclusive possession for a term at a rent. Sometimes it may be difficult to discover whether, on the true construction of an agreement, exclusive possession is conferred. Sometimes it may appear from the surrounding circumstances that there was no intention to create legal relationships. Sometimes it may appear from the surrounding circumstances that the right to exclusive possession *827

is referable to a legal relationship other than a tenancy. Legal relationships to which the grant of exclusive possession might be referable and which would or might negative the grant of an estate or interest in the land include occupancy under a contract for the sale of the land, occupancy pursuant to a contract of employment or occupancy referable to the holding of an office. But where as in the present case the only circumstances are that residential accommodation is offered and accepted with exclusive possession for a term at a rent, the result is a tenancy.

The position was well summarised by Windeyer J. sitting in the High Court of Australia in *Radaich v. Smith (1959) 101 C.L.R. 209*, 222, where he said:

'What then is the fundamental right which a tenant has that distinguishes his position from that of a licensee? It is an interest in land as distinct from a personal permission to enter the land and use it for some stipulated purpose or purposes. and how is it to be ascertained whether such an interest in land has been given? By seeing whether the grantee was given a legal right of exclusive possession of the land for a term or from year to year or for a life or lives. If he was, he is a tenant. and he cannot be other than a tenant, because a legal right of exclusive possession is a tenancy and the creation of such a right is a demise. To say that a man who has by agreement with a landlord, a right of exclusive possession of land for a term is not a tenant is simply to contradict the first proposition by the second. A right of exclusive possession is secured by the right of a lessee to maintain ejectment and, after his entry, trespass. A reservation to the landlord, either by contract or statute, of a limited right of entry, as for example to view or repair, is, of course, not inconsistent with the grant of exclusive possession. Subject to such reservations, a tenant for a term or from year to year or for a life or lives can exclude his landlord as well as strangers from the demised premises. All this is long established law: see *Cole on Ejectment (1857)* pp. 72, 73, 287, 458.'

My Lords, I gratefully adopt the logic and the language of Windeyer J. Henceforth the courts which deal with these problems will, save in exceptional circumstances, only be concerned to inquire whether as a result of an agreement relating to residential accommodation the occupier is a lodger or a tenant. In the present case I am satisfied that Mrs. Mountford is a tenant, that the appeal should be allowed, that the order of the Court of Appeal should be set aside and that the respondent should be ordered to pay the costs of the appellant here and below.

Representation

Solicitors: Park Nelson & Doyle Devonshire for D'Angibau & Malim, Bournemouth ; Bower Cotton & Bower for Richards & Morgan, Bournemouth .

Appeal allowed with costs in House of Lords and in Court of Appeal. (C. T. B.)

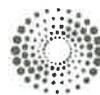
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**GOODE AND GULLIFER ON LEGAL PROBLEMS
OF CREDIT AND SECURITY**

SIXTH EDITION

**ROY GOODE
LOUISE GULLIFER**

SWEET & MAXWELL



THOMSON REUTERS

three distinct legal facts: first, that his security has attached, in the sense that it has fastened on the asset so as to give the creditor rights over the asset vis-à-vis the debtor; secondly, that it has been perfected, i.e. all steps have been taken to preserve its validity against third parties; thirdly, that it will have priority under the relevant priority rules.

2. THE CONCEPT OF SECURITY

Attachment and perfection of security interests are discussed in the next chapter. But first we must explore the different kinds of security and the legal nature of a security interest. The ingenuity of financiers and their legal advisers has given rise to many forms of agreement which are intended to provide security but do not in law create a security interest. Among such quasi-security devices are the reservation of title under a contract of sale, contractual set-off and the imposition of restrictions on the withdrawal of a cash deposit, as well as title transfer arrangements, which are particularly important in relation to receivables¹³ and financial collateral.¹⁴

1-03

The problem is to distinguish true security from quasi-security, a matter on which legal opinion is at some points divided. The problem is not purely of theoretical interest, for where an agreement creates a security interest in law the debtor has a right to redeem and an interest in any surplus resulting from repossession and sale by the creditor, the security agreement may be registrable by statute and the tax and accounting treatment of the transaction may turn on the fact that it constitutes a security transaction.

The very concept of security varies from jurisdiction to jurisdiction, depending on the legal culture and the extent to which the law has been reformed along the lines of the functional approach set out below. It appears to be recognised everywhere that a security interest can be created by the grant of a right in an asset which the grantor owns or in which he has an interest, but legal systems differ as to whether it can also be created by the reservation of title. The most fundamental divide is between the formal and the functional approach. The formal approach is one which sharply distinguishes the grant of security from the retention of title under conditional sale, hire-purchase and leasing agreements, on the basis that the buyer, hirer or lessee has merely a possessory interest, subject to which the seller, owner or lessor continues to enjoy absolute ownership by virtue of the agreement between the parties. The functional approach treats a conditional buyer, a lessee with an option to purchase and, in many cases, a lessee under a finance lease, as the owner and the interest of the conditional seller or lessor as limited to a security interest, so that the reservation of title is equated with a purchase-money chattel mortgage. The functional approach is that adopted throughout the US under art.9 of the Uniform Commercial Code,¹⁵ throughout Canada under the Personal Property Security Acts based on art.9,¹⁶ in New Zealand under its Personal Property Securi-

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<http://www.unidroit.org/work-in-progress-studies/current-studies/mac-protocol#a6> [Accessed 10 July 2017].

¹³ See Ch.3, below.

¹⁴ See Ch.6, below.

¹⁵ Though art.9 has undergone radical changes over the years, the classic text remains the two volumes of G. Gilmore, *Security Interests in Personal Property*, ((Boston: Little, Brown & Company, 1965).

¹⁶ There are two basic models: the Ontario Personal Property Security Act and the Model Personal Property Security Act of the Canadian Conference on Personal Property Security Law adopted, with local variations, by the Western Provinces. See R.C.C. Cuming, C. Walsh & R.J. Wood, *Personal*

4 THE NATURE AND FORMS OF CONSENSUAL SECURITY

ties Act 1999,¹⁷ which came into force in 2002, and in Australia under its Personal Property Securities Act 2009, which came into force in 2012,¹⁸ and, to a greater or lesser extent, in many other jurisdictions which have recently reformed their law along the lines of the PPSA system.¹⁹ The legal systems of other countries, including the UK,²⁰ and legal systems belonging to the common law family outside North America, New Zealand and Australia²¹ and to the civil law family, adhere to the formal approach.²²

This does not mean that English law looks always to the form of a transaction and not to the substance. If, for example, a document is a sham designed to disguise the true nature of the agreement reached by the parties, the court will look behind the document to ascertain the real character of the transaction.²³ Again, if the document is a true record of the agreement but its terms indicate that its legal character is not that ascribed to it by the parties—as where a transaction described as a lease is in fact a conditional sale—the court will disregard the label attached by the parties and look to the legal substance. The nature of the rights intended to be conferred by the parties is to be ascertained from the terms of their agreement; the characterisation of such rights is a matter of law and is to be determined by the

Property Security Law, 2nd edn (Toronto: Irwin Law, 2012).

¹⁷ As amended in 2001. For excellent analyses see L. Widdup and L. Mayne, *Personal Property Securities Act: A Conceptual Approach*, 3rd edn (Wellington: Butterworths, 2012); and M. Gedy, R. Cumming and R. Wood, *Personal Property Securities in New Zealand*, (Wellington: Thomson Brookers, 2002).

¹⁸ See A. Duggan and D. Brown, *Australian Personal Property Securities Law*, 2nd edn (London: LexisNexis Butterworths, 2016); see also B. Whittaker, *Review of the Personal Property Security Act 2009* (Australia: Attorney General's Department, 2015) <https://www.ag.gov.au/consultations/pages/StatutoryreviewofthePersonalPropertySecuritiesAct2009.aspx> [Accessed 10 July 2017].

¹⁹ For example, some African countries (e.g. Sierra Leone, Zambia, Liberia, Ghana, Malawi and Nigeria), some European countries (e.g. Belgium, Romania, Hungary), Latin American countries (e.g. Mexico, Colombia, Honduras) and many Pacific Islands (Federated States of Micronesia, the Republic of the Marshall Islands, Tonga, Vanuatu, the Solomon Islands, Palau).

²⁰ There are, however, marked differences between English law and Scots law.

²¹ Note that Jersey (though not wholly a common law jurisdiction) has started the process of reform of its law of personal property security, although so far the legislation is limited to security over intangibles, see Security Interests (Jersey) Law 2012. Reform of the law relating to taking security over tangibles is under way, see <http://www.gov.je/Government/Consultations/Pages/SecurityInterestsStage2.aspx> [Accessed 10 July 2017].

²² A number of bodies have considered reform of the law in England and Wales along the lines of art.9: see The Crowther Committee, *Report of the Committee on Consumer Credit* (1971), Cmnd.4506 Ch.5.5. This recommendation was endorsed by the Insolvency Law Review Committee in its report, *Insolvency Law and Practice* (1982), Cmnd.8558, paras 1620–1623; and by the report of Professor A. Diamond, *A Review of Security Interests in Property* (HMSO, 1989). Following a recommendation by the Company Law Review Steering Group in its Final Report, the Law Commission examined the current system and possible reform. In its Consultative Report No.176 (2004), *Company Security Interests*, the Law Commission set out a possible scheme for England and Wales based on the Personal Property Securities schemes of Canada and New Zealand. Following further consultation, it set out a modified version of this scheme in its final report: Law Commission, *Company Security Interests* (2005) Law Com. No.296; see para.2-33, below. The Scottish Law Commission is considering reform of the law of security at the moment, and published a Discussion Paper in June 2011; Scottish Law Commission, *Discussion Paper on Moveable Transactions* (June 2011) DP 151 and and consultation on draft Bill at <https://www.scotlaw.com.gov.uk/news/consultation-on-draft-moveable-transactions-scotland-bill/> [Accessed 10 July 2017]. See further <http://www.scotlaw.com.gov.uk/law-reform-projects/security-over-corporeal-and-incorporeal-moveable-property/> [Accessed 10 July 2017]. Secured Transactions Law Reform Project, *Draft Policy Paper* (April 2016) <https://securedtransactionslawreformproject.org/draft-policy-paper/> [Accessed 10 July 2017].

²³ See *Welsh Development Agency v Export Finance Co Ltd* [1992] B.C.L.C. 148 at 186.

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²⁴ *Welsh Development Agency v Export Finance Co Ltd* [1992] B.C.L.C. 148 at 186.

²⁵ i.e. the Bills of Sale Act 1875.

²⁶ *McEntire v Cross* [1992] B.C.L.C. 148 at 142.

²⁷ Note that "possessory interests" are defined in the Council Directive 2002/43/EC (2002/43/EC) (2002/43/EC) [2002] O.J. L160/12.

²⁸ In relation to a lien.

²⁹ Law of Property Act 1925, s.1.

³⁰ A demand guarantee is a security interest in favour of the beneficiary to whom the presentation of a bill of exchange does not constitute

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court.²⁴ But it is the legal substance to which the court has regard, not the economic effect. English law recognises that the parties are free to structure their transaction as they wish, and that there is nothing objectionable to their selecting, say, conditional sale or hire-purchase instead of a purchase-money chattel mortgage in order to avoid the application of the Bills of Sale Acts.²⁵ So in determining the substance of the transaction the court looks to what the parties have actually agreed.²⁶

There is also a divergence between legal families in the concept of possession. In common law systems possession denotes either physical possession or control through a physical possessor or means of physical access such as a key,²⁷ so that pure intangibles cannot be given in pledge or be the subject of a lien as this requires the delivery of possession.²⁸ Civil law systems likewise require possession for a pledge but by a legal construct treat intangibles as notionally delivered if certain formalities are complied with, for example, registration in a public register.

3. THE CLASSIFICATION OF SECURITY

The only forms of consensual security known to English law are the mortgage, which is a security transfer of ownership; the pledge, which creates a limited legal interest by the delivery of possession; the contractual lien, which differs from the pledge only in that the creditor's possession was acquired otherwise than for the purpose of security, as where goods are deposited for repair and the repairer then asserts a lien for unpaid repair charges; and the chargee. Except in the case of land, where statute provides for a charge by way of legal mortgage,²⁹ all charges are equitable.

1-05

Security may be classified in a number of different ways.

Real and personal security

Real security means security in an asset, whether of the debtor or of a third party. The asset may be tangible or intangible. Real security is to be contrasted with personal security, that is, security in the form of a personal undertaking which reinforces the debtor's primary undertaking to give payment or other performance. Typically the personal undertaking is given by a third party, for example, as a surety under a suretyship guarantee or a guarantor under a demand guarantee.³⁰ But the debtor too can provide a personal undertaking in a stronger or more easily assign-

1-06

²⁴ *Welsh Development Agency v Export Finance Co Ltd* [1992] B.C.L.C. 148; and see the decision of the Privy Council in *Agnew v Commissioners of Inland Revenue* [2001] 2 A.C. 710; para.1-36, below.

²⁵ i.e. the Bills of Sale Acts 1878-91, see para.2-16, below.

²⁶ *McEntire v Crossley Brothers Ltd* [1895] A.C. 457, per Lord Herschell LC at 462-463. See further paras 1-36 to 1-42.

²⁷ Note that "possession" may have a different meaning in the context of the Financial Collateral Arrangements (No.2) Regulations 2003 (SI 2003/3226) ("the FCARs") which enact the Financial Collateral Directive 2002 ("FCD"); see *In The Matter Of Lehman Brothers International (Europe) (In Administration)* [2012] EWHC 2997 (Ch) at [131]-[136] and paras 6-43 to 6-44, below.

²⁸ In relation to a lien, see *Your Response Ltd v Datateam Business Media Ltd* [2014] EWCA Civ 281.

²⁹ Law of Property Act 1925 s.85(1); Land Registration Act 2002 s.51.

³⁰ A demand guarantee is one which, though intended as between the account party (or principal) and the beneficiary to be called only upon the account party's default, is not dependent on default, only on presentation of a written demand and other specified documents. In other words, the requirement of default is confined to the internal relationship between account party and beneficiary and does not constitute a term of the guarantee itself. See para.8-02, below.

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:
DLA Piper LLP (US)
2000 Avenue of the Stars, Suite 400 North Tower
Los Angeles, CA 90067-4704

A true and correct copy of (I) the entitled *Trustee's Opposition to CAVIC Aviation Leasing (Ireland) 22 Co. Designated Activity Company's Motion to Dismiss Counts I, III, IV, V, and VI of Trustee's First Amended Adversary Complaint* will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner stated below:

1. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF): Pursuant to controlling General Orders and LBR, the foregoing documents were served by the court via NEF and hyperlink to the document. On October 8, 2021, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

Service information continued on attached page

2. SERVED BY UNITED STATES MAIL:

On October 8, 2021, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on October 8, 2021, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

VIA HAND DELIVERY

VIA ELECTRONIC MAIL

(Party, who is being served if different, and email address for each)

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

October 8, 2021
Date

William L. Countryman, Jr.
Printed Name

/s/ William L. Countryman, Jr.
Signature

This form is mandatory. It has been approved for use by the United States Bankruptcy Court for the Central District of California.

Counsel via Electronic Mail

**Bombardier Aerospace Corporation and
Bombardier, Inc.**

Attn.: Matthew S. Walker
Email: matthew.walker@pillsburylaw.com

Attn.: Andrew Troop
Email: andrew.troop@pillsburylaw.com

Attn.: Carolina A. Fornos
Email: carolina.fornos@pillsburylaw.com

**CAVIC Aviation Leasing (Ireland) 22 Co.
Designated Activity Company**

Attn.: Alan Watson
Email: alan.watson@hkllaw.com

Attn.: Robert J. Labate
Email: robert.labate@hkllaw.com

Attn.: Kristina S. Azlin
Email: Kristina.azlin@hkllaw.com

United States Trustee

Attn.: Dare Law
Email: dare.law@usdoj.gov

Attn.: Ron Maroko
Email: ron.maroko@usdoj.gov

Attn.: Jill Sturtevant
Email: jill.sturtevant@usdoj.gov

Attn.: Peter C. Anderson
Email: peter.c.anderson@usdoj.gov

This form is mandatory. It has been approved for use by the United States Bankruptcy Court for the Central District of California.