# CHAPTER 1

# The Nature and Forms of Consensual Security

## 1. THE PURPOSES OF SECURITY

**1–01** A financier taking security for an advance[1] is concerned to see that if the debtor's assets are insufficient to meet the claims of all his creditors the financier will at least be able to look to his security to obtain total or partial payment. So the primary purpose of security is to reduce credit risk and obtain priority over other creditors in the event of the debtor's bankruptcy or liquidation. However, there is no necessary connection between security and priority. For policy reasons the law allows certain classes of unsecured claim priority over certain classes of secured claim. For example, in a winding up preferential creditors have priority over a floating charge,[2] while the secured claims of directors of a company may in certain circumstances be subordinated to the claims of general unsecured creditors.[3] Nevertheless it remains the general principle that a secured creditor has priority over an unsecured creditor.

A secondary, but important, consideration is that security gives the creditor a certain measure of influence or control over events. This is particularly true of a creditor holding a fixed and floating charge covering substantially the whole of a debtor company's assets. The priority enjoyed by the chargee is likely to deter unsecured creditors from precipitate enforcement action which might inhibit the orderly reorganisation of the company or the sale of the company as a going concern or effective realisation of its assets. Moreover, a creditor holding a charge of the kind described above until fairly recently had as one of its most powerful remedies the appointment of an administrative receiver, empowered to assume the management of the company in place of its directors, to carry on the business with a view to sale, hiving down of the company to a newly formed subsidiary, or disposal of the assets. Administrative receivership, a widely used

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[1] The term "security" should not be confused with securities such as shares and bonds. It would be preferable to adopt the term "collateral" for the former, widely used in international finance, at the risk of offending traditionalists who do not care to see English adjectives converted into American nouns! However, the terms are not entirely interchangeable, since in relation to dealings in investment securities the provision of collateral is taken to include sale and repurchase agreements because these serve a security function even though not constituting security agreements in law. See para.6–27, below.

[2] Insolvency Act 1986 s.175(2)(b). See para.5–68, below.

[3] For example, one of the sanctions for fraudulent or wrongful trading by a director of a company in liquidation is subordination of his debt, wholly or in part, to all other debts of the company (Insolvency Act 1986 s.215(4)).

mode of enforcing security, has now been replaced by administration,[4] with certain exceptions related to the capital and financial markets. The holder of a fixed and floating charge still, however, has considerable influence and control in the event of the debtor's insolvency: it can appoint an administrator out of court,[5] and is often the main force behind the use of a pre-packaged administration.[6]

1–02 There are other reasons too for taking security. The holding of security is relevant to the risk-weighting of capital for capital adequacy purposes under Basel III[7]; and where the collateral consists of investment securities held with a right of "use" (including sale) this enhances the creditor's ability to raise funds itself and engage in market operations.

From the viewpoint of the borrower, the ability to furnish security may give it access to funds which might not otherwise be available or might be offered on more expensive terms. Historically the most important subjects of security were tangible assets: land and goods. With the development of documentary intangibles[8] the pledge could be extended to embrace documents of title to goods, negotiable instruments and negotiable securities. Pure intangibles, such as receivables and securities, also became increasingly important as security, a move sharply accentuated when paper-based securities were increasingly replaced by electronic securities and direct holdings from the issuer by indirect holdings through a securities account with a bank or other securities intermediary.[9] The position now is that intangible property is far and away the most significant form of collateral, and in the securities field alone some billions of pounds of value are transferred every day. Yet physical collateral continues to play a significant role in finance, and this is particularly true of cross-border dealings in mobile equipment of high unit value or economic importance. Hence the potentially huge impact of the 2001 Cape Town Convention on International Interests in Mobile Equipment, which provides an international regime governing security, title retention and leasing interests in aircraft objects, space assets and railway rolling stock.[10]

The secured creditor's protection against competing interests predicates at least 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.

[4] By the reforms introduced by the Enterprise Act 2002. See Ch.4, below; and L. Gullifer, "The Reforms Of The Enterprise Act 2002 And The Floating Charge As A Security Device" (2008) 46 C.B.L.J. 399.

[5] Pursuant to Insolvency Act 1986 Sch.B1 para.14.

[6] For discussion of the "pre-pack" see R. Goode, *Principles of Corporate Insolvency Law*, 4th edn (London: Sweet & Maxwell, 2011) paras 11–37 et seq.

[7] Agreed in December 2010 and revised in June 2011, and implemented by the Capital Requirements Directive (2013/36/EU). The bulk of the rules will apply from January 1, 2014.

[8] See para.1–48, below.

[9] See paras 6–02 et seq., below.

[10] For a comprehensive analysis, *Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment: Official Commentary,*see R. Goode, 3rd edn (Rome: UNIDROIT, 2013). The Convention has been ratified by 58 States, but not yet by the UK.





## 2. THE CONCEPT OF SECURITY

1–03 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 receivables[11] and financial collateral.[12]

The problem is to distinguish true security from quasi-security, a matter on which legal opinion is at some points acutely 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.

1–04 The very concept of security varies widely from jurisdiction to jurisdiction, depending as it does on concepts of ownership and possession which are inherently fluid. It appears to be recognised everywhere that a security interest involves the grant of a right in an asset which the grantor owns or in which he has an interest, but legal systems differ in their concept of ownership for this purpose. 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,[13] throughout Canada under the Personal Property Security Acts based on art.9,[14] in New Zealand under its Personal Property Securities Act

[11] See Ch.3, below.

[12] See Ch.6, below.

[13] 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: Law Book Exchange, 1999).

[14] 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. For a penetrating treatment of the whole subject in the context of the Ontario Act, see J. S. Ziegel and D. L. Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis*, 2nd edn (Ontario: Butterworths & Company (Canada) Ltd, 2000).



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1999,[15] which came into force in 2002, and in Australia under its Personal Property Securities Act 2009, which came into force in 2012.[16] The legal systems of other countries, including the United Kingdom,[17] and legal systems belonging to the common law family outside North America, New Zealand and Australia[18] and to the civil law family, adhere to the formal approach.[19]

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.[20] 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 court.[21] 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

[15] 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. Gedye, R. Cuming and R. Wood, *Personal Property Securities in New Zealand*, (London: Sweet & Maxwell, 2002).

[16] See A. Duggan and D. Brown, *Australian Personal Property Securities Law* (Lexis Nexis Butterworths, 2012).

[17] There are, however, marked differences between English law and Scots law.

[18] 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 September 18, 2013].

[19] A number of bodies have considered reform of the law in England and Wales along the lines of art.9: see the 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. See further; http://www.scotlawcom.gov.uk/law-reform-projects/security-over-corporeal-and-incorporeal-moveable-property/ [accessed September 18, 2013].

[20] See *Welsh Development Agency v Export Finance Co Ltd* [1992] B.C.L.C. 148, 186; and, for an exhaustive analysis, W.J. Gough, *Company Charges*, 2nd edn (London: Butterworths, 1995), Ch.21.

[21] *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.





chattel mortgage in order to avoid the application of the Bills of Sale Acts.[22] So in determining the substance of the transaction the court looks to what the parties have actually agreed.[23]

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,[24] so that pure intangibles cannot be given in pledge as this requires the delivery of possession. 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. A striking example is the fact that most securities issued in France in dematerialised form are characterised by French law as bearer securities.

## 3. THE CLASSIFICATION OF SECURITY

**1–05** 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,[25] all charges are equitable.

Security may be classified in a number of different ways.

### Real and personal security

**1–06** 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.[26] But the debtor too can provide a personal undertaking in a stronger or more easily assignable form than his primary undertaking, as, for example, by giving a negotiable instrument as security for payment. The greater part of this

[22] i.e. the Bills of Sale Acts 1878–91.

[23] *McEntire v Crossley Brothers Ltd* [1895] A.C. 457, per Lord Herschell L.C. at 462–463. See further paras 1–36 et seq.

[24] Note that "possession" may have a different meaning in the context of the Financial Collateral Arrangements (No.2) Regulations 2003 (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 6–33 et seq.

[25] Law of Property Act 1925 s.85(1); Land Registration Act 2002 s.51.

[26] 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.



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and more recently in New Zealand, and in Australia.[331] However, the project of the Law Commission of England and Wales on registration of company charges[332] looks unlikely to lead to legislative reform in the near future.[333]

[331] New Zealand Personal Property Securities Act 1999 and the Australian Personal Property Securities Act 2009.
[332] Law Commission, *Company Security Interests*, Law Com No.296 (2005).
[333] See para.2–33, above.



# CHAPTER 5

# Fixed and Floating Charges: Some Problems of Priority

## 1. INTRODUCTION

**5–01** The holder of a security interest may well find himself in competition with others claiming rights in the collateral. The competitor may be an outright buyer, another secured creditor, an execution creditor, a landlord or other person claiming a right to distrain on the collateral, a liquidator seeking to invalidate the security interest and thereby claim the collateral for the benefit of the general body of creditors, or some other contender for superior rights. The considerations which lead to the taking of security in the first place[1] also apply to the priority of the interest taken. The primary concern, as before, is to provide the secured creditor with safeguards against the debtor's insolvency. If it were not for insolvency, the creditor would, sooner or later, recover his money with or without security and regardless of the ranking of any security taken. It is the risk of the debtor's insolvency that is the prime factor in the decision to take security, but the value of the security interest depends upon its priority. This does not, of course, mean that second, or even third, mortgages or charges have no value, merely that each successive mortgagee or chargee must be satisfied that after giving the prior security interests the debtor retains sufficient equity in the asset to provide the assurance each junior incumbrancer requires. However, a first mortgage is obviously superior to a second, not only because the first mortgagee has the primary claim on the asset but also because priority gives him control in the event that the debtor gets into financial difficulties. This control used to be at its most visible when a creditor holding a floating charge covering, with any fixed charges, the whole or substantially the whole of a debtor company's property appointed an administrative receiver to run the business, where possible sell it as a going concern either directly or through a hive-down[2] and pay off his debenture holders.[3] The creditor in a similar position now has the ability to appoint an

[1] See para.1–01, above.
[2] A procedure by which some or all of the assets of the company are sold, without transfer of the liabilities, to a specially formed subsidiary which is controlled by the receiver and which as a clean company free of debt may be able to trade profitably with a view to its sale, the proceeds flowing back to the company in payment of the price for the transferred assets. See generally Lightman and Moss, *The Law of Receivers and Administrators of Companies*, 5th edn (London: Sweet & Maxwell/ Thomson Reuters, 2011), paras 11–081 et seq.
[3] The receiver also has a duty to discharge preferential debts from the proceeds of assets subject to a floating charge to the extent that the company's free assets are not sufficient for the purpose. See para.5–68, below. For the near-demise of administrative receivership, see para.4–09, above.



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administrator out of court, which gives less but still significant control.[4] Further, the holder of a first fixed charge or mortgage over a particular asset can still appoint a receiver[5] or enforce its security interest by sale or other means.[6] It is in the priority stakes that perfection of a security interest[7] acquires significance. Perfection does not guarantee priority, but an unperfected security interest will almost always be subordinated to or displaced by competing interests and by unsecured creditors in the debtor's bankruptcy or winding up.

The subject of priorities is of great complexity because English law has never developed a coherent legal structure for the ordering of competing interests. The common law adopted a straightforward first-in-time principle. The development of equitable ownership and security interests brought in its train a number of refinements, such as the relationship between an equitable interest and a subsequent legal title, priority as between competing equitable interests, including interests in debts and other intangibles, and the concepts of inferred and constructive notice of an interest. The introduction of a variety of statutory registration systems, each with its own priority rules and its own sanctions for failure to register, added to the complexity, and this has been exacerbated by the dual perfection requirements imposed by s.859A of the Companies Act 2006 and statutory provisions regulating the various specialist registers.[8] The courts have also had to consider the extent to which registration of a charge constitutes constructive notice of the existence of the charge and of its provisions. The result is an amalgam of common law rules and statutory provisions many of which lack any rational policy or responsiveness to modern commercial and financial requirements and by their complexity add significantly to transaction costs.

5–02 That this state of affairs continues to be tolerated in the 21st century, when the US and Canada have for many years had highly developed, market-responsive legislation which has worked[9] and when successive government reports have recommended the adoption of similar legislation in this country,[10] is a shocking indictment of the indifference of successive governments to the modernisation of our commercial law. It is, furthermore, very unfortunate that the work of the Law Commission on registration of company charges,[11] which the Law Commission rightly concluded could not be considered in isolation from general issues of perfection and priorities, led to no legislative response in the Companies Act 2006, and that the reforms introduced in April 2013[12] were very limited in scope, and did not address issues of priority. It is therefore necessary to examine the

[4] See para.4–40, above.

[5] Pursuant to a power in the security agreement, or, if the agreement is by deed, under the power in Law of Property Act 1925 s.101.

[6] Either pursuant to an express power in the agreement or, again if the agreement is by deed, under the power in Law of Property Act s.101. Once the underlying obligation has become due, a mortgagee also has a power of sale implied by law, *Re Morritt* (1886) L.R. 18 QBD 222, 233; *Deverges v Sandeman, Clark & Co* [1902] 1 Ch. 579, 588–589.

[7] See paras 2–16 et seq., above.

[8] See paras 2–21 and 2–32 et seq., above.

[9] And which has now been adopted in New Zealand and Australia, as well as in Jersey. See para.1–04, above.

[10] See para.1–04, fn.19, above.

[11] Law Commission, *Company Security Interests (a consultative report)*, Law Com. CP/176/2004; Law Commission, *Company Security Interests*, Law Com. No.296 (2005).

[12] See Ch.2, above.





current rules critically, and for work to continue on consideration of further reform.[13] At the outset we need to be aware of the fundamental difference between a fixed mortgage or charge and a floating charge. In relation to the subject of a fixed charge, the priority of the charge as against competing interests is governed primarily by rules of property law and equity.[14] But in the case of assets the subject of a floating charge, the power of disposition given to the company attracts rules of commercial law as well, for the company is trading in the assets comprising the security with the consent of the debenture holder, so that under the principle of authority akin to that which underlies agency law the debenture holder's security interest may be overreached by a disposition which is within the company's actual or ostensible powers of management. This does not mean that the company is the agent of the debenture holder; on the contrary, the company deals with the charged assets on its own behalf. But in so doing it is held out by the debenture holder as authorised to deal with the assets in the ordinary course of business free from the floating charge, and a third party taking without notice of any restriction of such authority is thus entitled to the act in reliance on the company's apparent powers of disposition even if the transfer to the third party is in breach of the terms of the debenture. In general, those apparent powers are limited only by the requirement that the dealing be in the ordinary course of the company's business, a requirement liberally interpreted by the courts.[15] Accordingly priority issues arising in relation to floating charges will be examined separately.

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## 2. PRINCIPLES OF PRIORITY AT COMMON LAW[16]

5–03 The following are the principal priority rules established at common law to regulate the priority of competing fixed interests generally.[17] The impact of legislative registration requirements on competition between fixed security interests is discussed in Section 3; and between a fixed security interest and other types of interest in Section 4; while the ranking of the floating charge is examined in Section 5.

### Rule 1: nemo dat quod non habet

5–04 A person cannot in general transfer a better title than he himself possesses.

Another formulation of the rule is that as between competing interests the first-in-time prevails. The first formulation is usually used in relation to competing legal interest in goods, the second to competing equitable interests and interests in land. The rule applies where the competing interests are both legal

[13] See para.2–33, above for discussion of the various reform projects that are currently in train.

[14] See below.

[15] See para.5–40, below.

[16] "Common law", as opposed to statute, is here used in its broad sense of judge-made law, including equity.

[17] For a very clear description of the principal rules, see the judgment of Millett J. in *Macmillan Inc v Bishopsgate Investment Trust Plc (No.3)* [1995] 1 W.L.R. 978 at 999 et seq.

interests and also where they are both equitable interests.[18] However, in a competition between an equitable interest and a subsequent legal interest, this rule may be overridden by r.2, below. It follows that as between competing equitable interests, the conversion of one of these into a legal interest may move the case from r.1 to r.2.

Rule 1 is subject to a number of exceptions at common law.[19]

## Common law exceptions to the nemo dat rule

### *(1) Actual or apparent (ostensible) authority*

5–05 A non-owner can sell or charge an asset if he has either actual or apparent (ostensible) authority from the owner to do so. Even if not in fact authorised to make the disposition, he will have apparent authority to do so if he has been held out by the owner as authorised to dispose; and where there is such a holding out, an innocent third party will not be bound by limitations on the power of disposal which were not known to him.[20] This principle is of particular importance in the case of the floating charge. The chargee confers on the chargor power to deal with its assets in the ordinary course of business free from the charge, but may seek to impose restrictions on the exercise of such power. The question then is what steps are necessary and sufficient to give notice of those restrictions to third parties, a matter discussed earlier.[21]

### *(2) Apparent ownership*

5–06 Distinct from apparent authority is the concept of apparent ownership, where the owner of an asset holds out another as being the owner. This is significantly wider in its effect in that while an unauthorised disposition by an agent binds his principal only if the agent acts within the scope of his apparent authority, no such limitation applies to a disposition by a person invested with apparent ownership, for an owner needs no authority, so that the fact that the disposition is on unusual terms or not in the ordinary course of business is irrelevant except so far as it bears on the transferee's good faith and the reasonableness of his belief that the transferor was the owner.[22]

### *(3) Postponement of equitable interest to subsequent legal interest*

5–07 An equitable interest is in certain circumstances postponed to a subsequent legal interest. See r.2, below.

[18] The first in time rule applies to equitable interests even when the second is taken for value and without notice of the first (*Phillips v Phillips* (1861) 4 De. G. F. & J. 208).

[19] For the statutory exceptions, see paras 5–13 et seq., below.

[20] For a detailed treatment, see *Bowstead & Reynolds on Agency*, P.G. Watts (ed.), 19th edn (London: Sweet & Maxwell/Thomson Reuters, 2010), paras 8–013 et seq. In the context of security interests, see also H. Beale, M. Bridge, L. Gullifer and E. Lomnicka, *The Law of Security and Title-Based Financing*, 2nd edn (Oxford: Oxford University Press, 2012), Ch.15.

[21] See paras 2–25 et seq., above.

[22] *Lloyds and Scottish Finance Ltd v Williamson* [1965] 1 W.L.R. 404, 410. See also *Bowstead & Reynolds on Agency* (2010), para.8–127 fn.755.





### *(4) Successive assignments of choses in action*

5–08 The priority of successive assignments of a debt or other chose in action is governed by the rule in *Dearle v Hall*[23] under which an assignee who takes without notice of an earlier assignment and is the first to give notice of assignment to the debtor obtains priority over the earlier assignee.[24] The rule applies also to a contest between the holder of an equitable right to claim a debt as proceeds of his property and a subsequent purchaser or mortgagee of the same debt.[25] The statutory provisions for registration of security interest considerably reduce the impact of the rule in *Dearle v Hall* in receivables financing, for the second assignee will usually have notice of a prior security interest by virtue of its registration.[26] The rule is wholly unsuited to modern receivables financing. Over a century ago Lord Macnaghten commented: "I am inclined to think that the rule in *Dearle v Hall* has on the whole produced at least as much injustice as it has prevented".[27] The proposals of the Law Commission for registration of all assignments of receivables,[28] would have replaced the rule in *Dearle v Hall* with a much more rational system of priority based on date of registration, in relation to receivables financing.

The rule does not apply at all in relation to the assignment of registered shares in a company, since the company can neither enter a notice of assignment in its register of members[29] nor validly accept such a notice,[30] and the same applies to an assignment of dematerialised ("uncertificated") securities registered electronically in the CREST system[31]; nor does the rule apply to a contest between the

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[23] *Dearle v Hall* (1828) 3 Russ. 1.

[24] The requirement that the later assignee be without notice of the earlier assignment, which is the so-called second limb of the rule in *Dearle v Hall*, was not in fact part of the decision in that case and was a refinement added by later cases. For a good historical account of the development of the rule see J. de Lacy, "Reflections on the Ambit of the Rule in *Dearle v Hall* and the Priority of Personal Property Assignments" (1999) 28 Anglo-Am. L.R. 87, 197.

[25] See para.5–37, below.

[26] See discussion in paras 2–25 et seq., above on what amounts to constructive notice.

[27] *Ward v Duncombe* [1893] A.C. 369 at 393. See also F. Oditah, *Legal Aspects of Receivables Financing* (London: Sweet & Maxwell, 1990), pp.140 et seq.; G. McCormack, *Secured Credit under English and American Law* (Cambridge: CUP, 2004), pp.244–245; Beale, Bridge, Gullifer and Lomnicka, *The Law of Security and Title-Based Financing* (2012), para.14.10.

[28] Law Commission, *Company Security Interests*, Law Com. No.296 (2005), Ch.4. The proposals were limited to assignments in the course of financing of trade receivables. For comment, see J. L. Yap, "Reconsidering Receivables" (2011) 32 Comp. Law. 297.

[29] Companies Act 2006 s.126, which provides that no notice of any trust, express, implied or constructive, shall be entered on the register. The assignment of shares constitutes the assignor a trustee for the assignee (*Hardoon v Belilios* [1901] 1 A.C. 118). Hence the method by which a mortgagee perfects his title is by entry on the register in place of the mortgagor, a process which is a novation, not an assignment. See para.3–14, above; para.6–38, below.

[30] *Société Générale de Paris v Walker* (1885) 11 App. Cas. 20, per Earl of Selbourne at 30–31, confirming that the rule in *Dearle v Hall* does not apply to registered shares. See also *Macmillan Inc v Bishopsgate Investment Trust Plc (No.3)* [1995] 1 W.L.R. 978, 993.

[31] Uncertificated Securities Regulations 2001 reg.23(3), which prohibits an Operator of a system from entering on its register notice of any trust, express, implied or constructive. Before he has been entered on the register a mortgagee or other transferee has a mere equitable interest, and this continues to be the case during the period between the time the transferor has been removed from the register and the time the transferee is entered on it, during which time the transferor is a trustee for the transferee (Uncertificated Securities Regulations 2001 regs 31(2) (b), 31(4)).

holder of a floating charge and a subsequent fixed chargee or assignee[32] or to the assignment of debt which by the terms of the contract creating it is non-assignable, for the debtor is then under no obligation to recognise a notice of assignment.[33] Further, the rule does not apply to a negotiable instrument, so if the holder of a bill of exchange assigns the underlying debt to A and then negotiates the bill to B, B has priority notwithstanding that A has given notice of assignment to the acceptor, for the latter is required to pay the current holder who presents the bill for payment, and no one else.[34]

## Rule 2: a legal interest acquired for value and without notice overrides prior equitable interest

5–09 An equitable interest is overreached by a disposition of the legal title to a bona fide purchaser for value without notice. The principle remains unaffected by the 1925 property legislation, but the registrability of most categories of security interest in one register or another makes it difficult for a subsequent legal purchaser to claim that he took without notice. However, the concept of notice continues to give rise to difficulties, as is discussed above.[35]

The time when the subsequent purchaser is required to be without notice is not when he takes the legal title but when he makes his advance. This rule enables the holder of a later equitable interest who makes his advance without notice of the prior equitable interest to effect a *tabula in naufragio* by getting in the legal title,[36] thereby securing priority even if by the time he takes the legal title he has acquired notice of the prior equitable right.[37] But it would seem that only a fixed equitable interest can be promoted in this way, and that the interest of the holder of a floating charge is too nebulous to enable him to jump ahead of a prior fixed charge by getting in the legal title after notice of the fixed charge. The *tabula in naufragio* is not available in the case of competing assignments of a debt. A statutory assignee, despite having the legal title, is postponed to a prior equitable assignee who gave notice first, for s.136 of the Law of Property Act 1925 expressly provides that the statutory assignee is to take subject to equities, and

[32] See para.5–40, below.
[33] See para.3–38, above.
[34] Indeed, even if the holder of the bill assigns it while retaining the instrument, the debtor can ignore the notice of assignment, for his duty remains to the holder who presents the bill, whether the holder is the assignor or anyone else (*Bence v Shearman* [1898] 2 Ch. 582).
[35] Paras 2–25 et seq., above.
[36] Or having the best right to the legal title, as where he procures the mortgaged property to be conveyed to trustees on his behalf, *Macmillan Inc v Bishopsgate Trust Plc (No.3)* [1995] 1 .L.R. 978, 1001.
[37] *Taylor v Russell* [1892] A.C. 244; *Bailey v Barnes* [1894] 1 Ch. 25. The rule applies also to a mortgage of shares, where a creditor who takes a share certificate and executed transfer by way of equitable mortgage and makes his advance without notice of a prior equitable interest can obtain priority by registering the transfer (*Dodds v Hills* (1865) 2 H. & M. 424; which Millett J. in *Macmillan Inc v Bishopsgate Investment Trust Plc (No.3)* [1995] 1 W.L.R. 978 considered (at 1004) to be still good law despite attacks made upon it).





this includes a prior equitable interest of which the debtor has been given notice.[38] However, a statutory assignee who collects payment without notice may be able to rely on his legal title.[39]

## Rule 3: a mortgagee may in certain conditions tack further advances for which he will rank in priority to a subsequent mortgagee

5–10 The common law attached great importance to the legal estate, so much so that it provided two situations in which a legal mortgagee or a person having the best right to under a mortgage could tack such advances to his initial advance and rank in priority to a subsequent mortgagee even if the mortgage was not expressed to cover further advances and even if these were not made until after the execution of the second mortgage. The first situation was where the further advances were made without notice of the second mortgage. Under the rule in *Hopkinson v Rolt*,[40] notice of the second mortgage terminated the right to tack further advances, a rule considered necessary to avoid the first mortgagee having a monopoly over the debtor's financing. The rule was applied even if the prior legal mortgagee was under an obligation to make the further advances[41]; this seems to undermine the rationale of *Hopkinson*, which was that the first mortgagee could decline to make further advances once it had notice of the second mortgage. However, if the first mortgage, as is common, includes a negative pledge clause[42] then the mortgagor will be in breach by granting a second mortgage without the consent of the first mortgagee, and this is likely to have the effect of giving the first mortgagee the right to refuse to make further advances even where it would otherwise be obliged to do so.[43] The second situation was the *tabula in naufragio*, where if a legal mortgage was granted to A followed by a mortgage to B and then a third mortgage to C, who made his advance without notice of B's mortgage, C could purchase A's interest and use the legal estate he had thereby acquired to tack his own advance in priority to B, who was thus squeezed out. In addition to these cases, any mortgagee, legal or equitable, could tack further advances if the mortgage expressly covered such advances and the mortgagee, at the time of making them, had no notice of the subsequent mortgage. As will be seen, the

[38] *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 W.L.R. 150; *Compaq Computers Ltd v Abercorn Group Ltd* [1991] B.C.C. 484. See also *Harding Corp Ltd v Royal Bank of Canada* [1980] W.W.R. 149. This view is strongly criticised by Oditah, *Legal Aspects of Receivables Financing* (1990), para.6.15; and see also G. Tolhurst, *The Assignment of Contractual Rights* (Oxford: Hart Publishing, 2006), Ch.5, who disagrees with the premise underlying these decisions that the difference between a statutory and an equitable assignment is procedural and not substantive.
[39] A point left open by Phillips J. in *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 W.L.R. 150 at 163 but conceded in *Compaq Computers Ltd v Abercorn Group Ltd* [1991] B.C.C. 484 at 500.
[40] *Hopkinson v Rolt* (1861) 9 Cas. 514.
[41] *West v Williams* [1899] 1 Ch. 132.
[42] See J. Porteous and L. Shackleton, "A question of great importance to bankers, and to the mercantile interests of the country" (2012) 7 J.I.B.F.L. 403.
[43] R. Calnan, *Taking Security, Law and Practice*, 2nd edn (London: Jordan Publishing, 2011), para.7–229.



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been made, for the effect of the payment is pro tanto to reduce the available amount of set-off against the account in credit, so that the position of other creditors is unaffected. Where, by virtue of an agreement between a company and its directors, the company has a contractual right to set-off against one director's credit balance amount due from another director, exercise of that right is not a preference of the first director, for it is for the company's benefit, not that of the first director.[580]

An assignment of a debt before the cut-off date is very unlikely to be set aside as a preference under s.239 of the Insolvency Act 1986, since the assignment is usually not "done" or "suffered to be done" by the insolvent debtor.[581] However, this is not an invariable rule, and it is still possible that an assignment could be a preference, if the relevant statutory requirements were met.

[580] *Re Exchange Travel (Holdings) Ltd (No.3)* [1996] B.C.L.C. 524.
[581] *Re Parkside International Ltd (In Administration)* [2008] EWHC 3554 (Ch).



# CHAPTER 8

# Some Aspects of Suretyship Law

**8–01** We will turn to the last topic, namely that of suretyship guarantees.[1] First some aspects of the general law on such guarantees outside insolvency will be considered and then the rights of the creditor in respect of a guaranteed debt where the debtor, the surety or both become bankrupt will be discussed. The term "bankrupt" includes the liquidation of a company, as the rules governing guarantees on a winding up or when a company is in administration are in all material respects the same as those applicable in bankruptcy, except as otherwise stated below.

## 1. GENERAL PRINCIPLES[2]

### The suretyship guarantee as an accessory contract

**8–02** A suretyship guarantee is an undertaking to be answerable for the debt or other default of another. The obligation is triggered by the default of the principal debtor. If the default is in payment of money, the surety's obligation is to pay what is due; if it is failure to perform a non-monetary obligation the surety has either to perform itself, if the contract so provides or permits, or to pay damages. The essential point is that a suretyship guarantee is an accessory contract, not a primary contract.[3] That is to say, the surety's obligations are co-terminous with

[1] The subject is bedevilled with problems of terminology. A traditional approach is to treat suretyship as covering both guarantees and indemnities (see, for example, G. Andrews & R. Millett, *Law of Guarantees*, 6th edn (London: Sweet & Maxwell, 2011), para.1.003 . However, in modern banking and commercial usage the term "suretyship guarantee" denotes a guarantee triggered by default on the part of the principal debtor, by way of contrast to "demand guarantee", which denotes an independent, primary undertaking (see below). The suretyship guarantee is also contrasted with the contract of indemnity, which is also a primary undertaking but differs from a demand guarantee in that typically it is an undertaking to cover the creditor's loss rather than an undertaking to pay a specified amount or maximum amount, so that the liability on an indemnity is unliquidated whereas that on a demand guarantee is liquidated.

[2] The leading English textbook on guarantees is Andrews & Millett, *The Law of Guarantees* (2011). See also *Rowlatt on Principal and Surety*, G. Moss & D. Marks (eds), 6th edn (London: Sweet & Maxwell, 2011); J.C. Phillips & J. O'Donovan, *The Modern Contract of Guarantee*, 2nd English edn (London: Sweet & Maxwell, 2010); K. P. McGuinness, *The Law of Guarantee*, 2nd edn (Toronto: The Carswell Company Ltd, 1996).

[3] The typical bond given by an insurer in relation to a construction contract whereby the bond is expressed to become void if the contractor fulfils its obligations is a suretyship bond, not an independent obligation to pay the amount of the bond, and accordingly loss must be proved (*Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] A.C. 199). The



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those of the principal debtor, his liability does not arise until the principal debtor has made default and anything which nullifies, reduces or extinguishes the liability of the principal debtor has the same effect on the liability of the surety.[4] This cardinal principle may, of course, be qualified or displaced by the terms of the guarantee.

The question whether and in what conditions a surety may invoke a right of set-off which the debtor has against the creditor remains controversial. In principle, a transaction (or equitable) set-off available to the debtor should equally be available to the surety, on the grounds that he has a right in equity against the principal debtor to exonerate him, so the principal debtor cannot refuse to rely on the set-off.[5] Thus, if the creditor applies for summary judgment against the surety, the latter can obtain leave to defend, although this will be on the condition that the principal debtor is joined as a defendant to the action before full trial.[6] By contrast, it is generally considered that an independent (or statutory) set-off exercisable by the debtor is not available to the surety since this is a procedural defence which arises from a transaction independent of that to which the guarantee relates[7] and takes effect only at the point of judgment for any balance.[8] Against this it has been argued that any form of set-off, including independent set-off, is available so long as the debtor is joined in the proceedings.[9] But it may be questioned on what basis the debtor should be forced to have his right of independent set-off exercised in favour of the surety when it has nothing to do with the guaranteed debt.[10]

distinction between primary and accessory obligations is not always easy to draw. See, for example, the decision of the Court of Appeal in *Actionstrength Ltd v International Glass Engineering In.Gl.En Spa* [2001] EWCA Civ 1477; [2002] 1 W.L.R. 566, which reversed the decision of the judge at first instance. There was an unsuccessful appeal to the House of Lords [2003] UKHL 17, but not on the characterisation of the guarantee.

[4] See Andrews and Millett, *Law of Guarantees* (2011), paras 1.005, 6.018 et seq.; Phillips & O'Donovan, *The Modern Contract of Guarantee* (1996), para.1–22.

[5] *Bechervaise v Lewis* (1871–72) L.R. 7 C.P. 372, 377.

[6] See J. Phillips, "When should the guarantor be permitted to rely on the principal's set-off" [2001] L.M.C.L.Q. 383; R. Derham, *The Law of Set-Off*, 4th edn (Oxford: Oxford University Press, 2010), para.18.25.

[7] See Phillips, "When should the guarantor be permitted to rely on the principal's set-off" [2001] L.M.C.L.Q. 383, P.Wood, *English and International Set-Off* (London: Sweet & Maxwell, 1989), paras 10–216, 10–227; Phillips & Donovan, *The Modern Contract of Guarantee* (2010), paras 11–71 et seq.

[8] See para.7–35, above.

[9] Derham, *The Law of Set-Off* (2010), paras 18.10 and 18.27; also *Halsbury's Law of England* (London: Butterworths Law, 2008), Vol.49 para.1135, "On being sued by the creditor for payment of the debt guaranteed, a guarantor may rely upon any right of set-off or counterclaim which the principal debtor could set up against the creditor in reduction of the guaranteed debt in reduction of the claim against him under the guarantee," previous versions of which were cited with approval in *Hyundai Shipbuilding & Heavy Industries Co Ltd v Pournaras* [1978] 2 Lloyd's Rep. 502, 508–509; *Barclays Bank Plc v Gruffydd* Unreported October 30, 1992; *BOC Group Plc v Centeon LLC* [1999] C.L.C. 497; and see *Marubeni Hong Kong and South China Ltd v Government of Mongolia* [2004] EWHC 472 (Comm) at [232], although the distinction between transaction and independent set-off was not discussed in any of the cases, and it is not clear that any of them concerned an independent set-off.

[10] Even if an independent set-off is not a defence, the surety could join the principal debtor as a third party claiming an indemnity and the principal debtor could, if it wished, join the creditor as a fourth party on the cross-claim. This would also be possible if the cross-claim were a counterclaim and not a set-off, see Derham, *The Law of Set-Off*, (2010), para.18.30.





The suretyship guarantee is to be distinguished from the demand guarantee and the standby letter of credit, which are primary undertakings and are payable solely on presentation of a written demand and other specified documents and, in the case of a demand guarantee governed by the ICC's Uniform Rules for Demand Guarantees, a statement that the principal is in breach and the respect in which it is in breach.[11] Demand guarantees and standby credits are, like documentary credits, independent of the underlying transaction, so that in the absence of clear evidence of fraud the issuer has to pay even if there has been no default in performance by the principal (the debtor of the obligation). For the beneficiary to make a demand when there has been no default may well be a breach of its obligation to the principal but that is of no concern to the issuing bank, which has entered into a separate engagement to pay on presentation of documents and is not concerned with the underlying contract or with non-documentary factors. The present chapter is confined to suretyship guarantees.

### *(1) Requirement of evidence in writing*

**8–03** Contracts of guarantee are one of the few remaining contracts which under the Statute of Frauds are unenforceable unless evidenced in writing signed by or on behalf of the surety.[12] The statute does not apply to demand guarantees, indemnities and standby letters of credit, which as stated above are independent payment undertakings and are in principle enforceable whether or not there has been default in performance of the underlying contract.

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### *(2) Unilateral and bilateral guarantees*

**8–04** The typical guarantee is a unilateral contract, i.e. there is a promise by one party only, the surety. The creditor does not usually undertake to the surety that he will make an advance to the debtor; it is merely agreed that if the creditor makes an advance, the surety guarantees repayment. In contract law terms, the surety's promise is a continuing offer which is to be accepted by the offeree's conduct in making the advance, until which time there is no contract and the surety can revoke the guarantee unless this otherwise provides.[13] The fact that the prospective creditor may have committed itself to the prospective debtor to make an advance is irrelevant, for it remains the case that until the advance is made there is no acceptance of the surety's offer and no contract of guarantee.

[11] Uniform Rules for Demand Guarantees art.15. See G. Affaki and R. Goode, *Guide to ICC Uniform Rules for Demand Guarantees* (International Chamber of Commerce (ICC) Publication, 2011).

[12] Statute of Frauds 1677 s.4. An email, or sequence of negotiating emails, will amount to a sufficient note or memorandum for the purposes of s.4, *Golden Ocean Group Ltd v Salgaocar Mining Industries Pvt Ltd* [2012] EWCA Civ 265. But it will not comply with the requirement of signature unless the guarantor's name appears at the bottom with the intention of this being a signature: the mere automatic insertion of the sender's email address is not enough, *Mehta v J Pereira Fernandes SA* [2006] EWHC 813 (Ch). The requirement under s.4 of the Statute of Frauds is strictly applied, even where the policy reasons behind it do not apply, and the mere agreement of the guarantor cannot amount to a representation sufficient to found an estoppel which would render the guarantee enforceable in the absence of writing (*Actionstrength Ltd v International Glass Engineering In.GL.en SpA* [2003] UKHL 17).

[13] *Offord v Davies* (1862) 12 C.B.N.S. 748.

However, if the consideration for the guarantee is indivisible, or entire, it is not necessary that the advance should be made in full in order for the surety to become bound. It is established that an offer to be accepted by performance ceases to be revocable once performance has begun.[14] So if the surety guarantees a prospective advance of £100 and in reliance on this the creditor commits itself to make such an advance but initially advances £40 as a first payment, the guarantee becomes irrevocable and the surety is committed not only for that advance but for further advances up to the balance of £60.[15] The position is otherwise if the consideration is divisible, as where the advance is to be made by five instalments of £20 each. In such a case each advance constitutes a separate acceptance and the surety can revoke his guarantee as to future instalments.

Where the guarantee is expressed to be given in consideration of the prospective creditor's agreeing with the creditor to make advances, the surety becomes committed to the creditor at the same time as the latter incurs a binding commitment to the prospective debtor, for that is the act of acceptance. If, by the terms of the guarantee, the prospective creditor also undertakes with the surety to make advances to the prospective debtor the guarantee is a bilateral contract and the surety becomes bound immediately.

## Continuing guarantees

**8–05** Similar considerations apply to a continuing guarantee, that is, a guarantee which is given not for a fixed advance but for all the debtor's obligations from time to time or for continuing advances on a current account, so that the surety in effect guarantees the ultimate debit balance.[16] In this case there is a separate acceptance of the surety's continuing offer each time an advance is made, so that the surety becomes committed as to all such advances but remains free to revoke the guarantee as to future advances.[17] A guarantee of obligations arising under a continuing contract between the debtor and the creditor, such as a factoring agreement, is impliedly terminated by the termination of the principal contract, since there are no future obligations under that contract to which the guarantee is capable of attaching, and this remains the case even if that contract is later restored. Accordingly in the absence of a fresh guarantee the surety's liability is limited to the obligations of the debtor under the principal contract prior to its termination.[18] Unless the guarantee is so revoked by notice to the creditor or is terminated by some legal event such as the surety's bankruptcy, the surety's liability continues until the debtor's account has been closed and the ultimate debit balance then struck and discharged.

The surety's ability to revoke a continuing guarantee is on the assumption that the consideration is divisible so that each advance is to be treated as a separate

[14] *Errington v Errington* [1952] 1 K.B. 290. The basis for this irrevocability is uncertain: for the possible analyses see G. Treitel, *The Law of Contract*, E. Peel (ed.), 13th edn (London: Sweet & Maxwell, 2011), para.2–053.

[15] If the creditor fails to fulfil its obligations the surety is not liable (*Errington v Errington* [1952] 1 K.B. 290).

[16] See below.

[17] *Coulthart v Clementson* (1879) 5 Q.B.D. 42.

[18] *Silverburn Finance (UK) Ltd v Salt* [2001] EWCA 279; [2001] 2 All E.R. (Comm) 438. See also *Close Brothers Ltd v Michael Roy Pearce* [2011] EWHC 298 (QB).





acceptance. Where, however, in reliance on the guarantee the creditor commits itself to allow the debtor a drawing facility up to a stated amount, then upon the first drawing being made the surety ceases to be able to revoke the guarantee even though the contract is unilateral, for the stipulated performance of an indivisible obligation has begun. The same applies to other types of indivisible obligation. For example, in *Lloyd's v Harper*[19] a father whose son was a candidate for underwriting membership of Lloyd's guaranteed all obligations of the son incurred in that capacity. The father later died and the question was whether notice of his death operated to revoke the guarantee. The Court of Appeal, upholding the decision of the trial judge, held that it did not. In contrast to the position in *Coulthart v Clementson*,[20] the consideration was an entire consideration given once and for all and there was no basis for limiting its scope to the lifetime of the surety or for treating the guarantee as revocable.

As before, if the creditor commits itself to the surety to give the drawing facility the guarantee is a bilateral contract and takes effect so as to bind the surety immediately.

**8–06** So long as a continuing guarantee remains in force, the order of receipts and payments passing through the debtor's account is of little significance, for the surety's indebtedness relates not to a specific drawing by the debtor but to a balance of account, and the rule in *Clayton's Case*[21] does not apply. The position is otherwise where an event occurs which causes the guarantee to come to an end. Unless the guarantee otherwise provides,[22] termination of the guarantee fixes the moment at which the debit balance must be struck. The surety is not answerable for future drawings or advances. It is therefore important that the creditor should freeze the debtor's account when the guarantee comes to an end, and place all future receipts to the credit of a separate account.[23] If this is not done, or the rule in *Clayton's Case* otherwise excluded, further sums paid to the credit of the principal debtor's account will go in reduction of the earliest indebtedness first—that is, the indebtedness covered by the guarantee—whilst new drawings will be outside the guarantee. *Clayton's Case* thus has the effect of converting guaranteed indebtedness into non-guaranteed indebtedness, since the amount of the former is reduced by each payment to the credit of the account.

Although in principle a continuing guarantee of a current account is revocable at any time as to future advances, this is subject to any contrary provision in the guarantee. Bank guarantees commonly provide for a period of three months' notice to be given to terminate a continuing guarantee. Such a provision not only ensures that the bank is covered for transactions in course of processing at the time the notice is received but also provides the bank and the debtor with an

[19] *Lloyd's v Harper* (1880) 16 Ch.D. 290.

[20] *Coulthart v Clementson* (1879) 5 Q.B.D. 42.

[21] *Clayton's Case* (1816)1 Mer. 527.

[22] As in *Westminster Bank Ltd v Cond* (1940) 46 Com. Cas. 60, where a clause in the guarantee was held effective to exclude the rule in *Clayton's Case* despite the fact that pursuant to the clause the bank made no break in the account.

[23] In the absence of an effective appropriation of the payment by the debtor to the existing account, the creditor is entitled to open a new account for the crediting and debiting of receipts and payments unless the guarantee otherwise provides (*Re Sherry* (1884) 25 Ch.D. 692). But it is sensible to follow the usual practice of providing for this specifically in the guarantee (or otherwise excluding the operation of the rule in *Clayton's Case*), so as to avoid the possibility of an appropriation by the debtor to the existing account.

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