CHAPTER 3

MORTGAGES AND CHARGES

PART 1: INTRODUCTION

3.01 It has been seen in Chapter 2 that the requirement of a pledge that the creditor has possession of the pledged asset severely limits its use in commercial transactions. But this limitation is of little practical importance because of the availability of two other forms of security – mortgages and charges. Although they are conceptually different, they will be treated together because, in practice, the distinctions between them are not great. More important are the factors which link mortgages and charges. They are both created by evidence of the intention of the debtor, they are both effective without any necessity for the creditor to obtain possession of the secured asset and they both give the creditor a proprietary interest in the secured asset which (although the nature of the interest varies depending on whether the security is a legal mortgage, an equitable mortgage or a charge) is effective in the debtor’s insolvency.

What is a mortgage?

3.02 A mortgage involves the transfer of the title to an asset as security for a liability.

3.03 The nature of a legal mortgage is described by Lindley MR in *Santley v Wilde*:1

> ‘The principle is this: a mortgage is a conveyance of land or an assignment of chattels as a security for the payment of a debt or the discharge of some other obligation for which it is given. This is the idea of a mortgage: and the security is redeemable on the payment or discharge of such debt or obligation ....’

3.04 An equitable mortgage has similar characteristics, the main differences being that it involves the transfer of beneficial (rather than legal) title and that it is available in respect of assets other than land or chattels.

3.05 There are therefore two elements of a mortgage:

- In the first place, title to an asset must be transferred to the creditor or to someone on his behalf. If it is legal title which is transferred, the mortgage is a legal mortgage. If beneficial title is transferred, it is an equitable

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1 [1899] 2 Ch 474 at 474.
mortgage. Either way, the creditor obtains a proprietary interest which remains effective in the insolvency of the debtor. It is not necessary for the creditor to take possession of the asset.

- The second element is that the transfer must be by way of security. The creditor is not intended to have the absolute entitlement to the asset concerned. It has been transferred to secure a liability and, once that liability has been discharged, the debtor is entitled to have the asset re-transferred to him. This right, which is itself a proprietary interest, is generally referred to as an ‘equity of redemption’. It is considered further in part 6 of this chapter (3.301ff).

What is a charge?

3.06 A charge is less easy to define. In distinction from a mortgage, the creditor does not obtain either legal or beneficial title to the charged asset. But what he does obtain is an equitable proprietary interest in the asset by way of security.

3.07 There have been a number of attempted definitions of a charge in the cases but, in one of the most recent, Re Bank of Credit and Commerce International (No 8),² Lord Hoffmann recognised the difficulty of providing an exhaustive definition. He contented himself with describing a charge as being a proprietary interest granted by way of security without a transfer of title or possession. It is also common to describe a charge as the appropriation of an asset in discharge of a liability. An example of such a description is that given by Peter Gibson J in Carreras Rothmans v Freeman Mathews Treasure.³ He said that a charge is created ‘by an appropriation of specific property to the discharge of some debt or other obligation without there being any change in ownership either at law or in equity …’.

3.08 These descriptions show that there are two elements of a charge:

- The creditor obtains an equitable proprietary interest in the secured asset, but does not obtain either legal or beneficial title to it. Nor is it required that the creditor takes possession of it.
- The creditor’s interest is given to him by way of security for the discharge of a liability so that, when the liability has been discharged, the charge terminates.

3.09 The second element is common to all types of security, but the first has caused more difficulty. It is easy to state what a charge does not involve: it does not involve the transfer of legal or beneficial title to the asset concerned, nor does it require possession to be transferred. But it is much more difficult to

³ [1985] 1 Ch 207 at 227.
define the precise nature of the interest obtained by the creditor in the asset concerned. Two things are, however, clear:

- A charge is an equitable concept, and the creditor’s interest is therefore equitable. The creditor does not obtain any common law rights in the asset concerned.
- The creditor’s right is proprietary, rather than merely personal, and is therefore effective in an insolvency of the debtor. For the same reason, it will bind the charged asset in the hands of third parties, subject to the rules concerning priorities, which are discussed in Chapter 7.

Does the distinction matter?

3.10 It has been seen that the main distinction between a mortgage and a charge is that a mortgagee obtains legal or beneficial title to the asset concerned, whereas a charge does not. Is the distinction important?

3.11 There have been cases where the distinction between a mortgage and a charge has been important. During the First World War, for instance, there was legislation in force which provided for security to have a different effect depending on whether it was a mortgage or a charge. The Court of Appeal had to consider that legislation in _London County & Westminster Bank v Tompkins_, and the requirement to do so led that eminent common lawyer, Scrutton LJ, to say that, although there was a distinction between a mortgage and a charge, ‘equity judges appear to use the terms with no such precise distinction’.

3.12 This failure to distinguish between mortgages and charges is understandable. They both give the creditor a proprietary interest in the asset concerned which is effective in the debtor’s insolvency. As far as rights against subsequent encumbrancers are concerned, the important distinction is not between mortgages and charges but between legal mortgages, on the one hand, and equitable mortgages and charges, on the other. It is generally easier to enforce legal rights against third parties than equitable rights (not least because of the principle that a person who acquires a legal interest in an asset for value and without notice of an earlier equitable interest will take free of that equitable interest).

3.13 Mortgages and charges are also generally treated in the same way in the relevant legislation. In the Companies Act 2006, which provides for the registration of charges created by companies, the expression ‘charge’ includes a

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4. [1918] 1 KB 515. The legislation is no longer in force.
5. [1918] 1 KB 515 at 528.
mortgage. The Law of Property Act 1925, which is the key legislation concerning security over land, conversely (but to the same effect) defines ‘mortgage’ to include a charge.

3.14 There are two minor differences between mortgages and charges. First, because a chargee does not obtain legal or beneficial title to the asset concerned, his powers of enforcement are more circumscribed than those of a mortgagee. Unlike a mortgagee, a chargee does not have a right of foreclosure or, in the absence of express provision in the charge document, a right to possession of the charged asset. In practice, however, charges invariably contain extensive powers of enforcement which give the chargee substantially the same powers as those of a mortgagee. These limitations on a chargee’s powers of enforcement are therefore of little relevance in practice. The powers of enforcement of secured creditors are considered in more detail in Chapter 8.

3.15 Secondly, it has been seen that a mortgagor’s equity of redemption enables the mortgagor to require the re-transfer of the asset to him on payment of the secured debt. This is not necessary where the creditor only has a charge over the asset concerned, because the charge terminates as soon as the secured liability has been paid. In the words of Stuart V-C in *Kennard v Futvoye*:

‘If there be a simple charge without an equity of redemption, that is, if there be nothing more than a debt charged upon an estate, without any conveyance of the estate to the creditor, or any right or equity of redemption reserved, such a security is not a mortgage … because a charge is at once extinguished by payment of the debt, and from its nature must subsist till the debt is satisfied.’

3.16 Although there is a conceptual distinction between a mortgage and a charge, the practical differences between them are therefore insufficiently important to require them to be considered separately. There is, however, an important distinction between:

- legal mortgages; and
- equitable mortgages and charges.

3.17 One of these distinctions has already been mentioned – the fact that it is generally easier to enforce a legal proprietary interest against third parties than an equitable one. This issue is considered further in Chapter 7. The distinction between legal and equitable interests is also very important when it comes to creating the security. There are more formal requirements for the creation of a legal mortgage than an equitable mortgage or a charge. It is also possible to create security over more types of asset in equity than it is at law. These issues are discussed further in this chapter. For all these reasons, it will be the

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6 Companies Act 2006, s 859A(7)(a).
7 Law of Property Act 1925, s 205(1)(xvi).
8 (1860) 2 Giff 81 at 92–93.
9 There is also a potential difference in relation to what are often known as ‘charge-backs’. These are described in Chapter 12 (12.183–12.185).