12. Borrowing, Debentures and Charges

Chapter: **(p. 594)** 12. Borrowing, Debentures and Charges
Author(s): Len Sealy and Sarah Worthington
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General issues

Most companies do not operate using only equity funding from shareholders. Borrowing from lenders, and use of credit such as deferred payment for goods and services, provide additional and important methods of financing corporate activity.

The rights of lenders (bank lenders, creditors, debenture holders, etc: see later) depend on the precise terms of their contract with the company. As a general rule, creditors are entitled to an agreed rate of interest (fixed or variable) regardless of the commercial success of the company. Their loan agreements may be secured or unsecured providing different protection to different creditors should the company become insolvent. However, all creditors are paid out, in full if possible, before the shareholders are entitled to any return (see Chapter 16). Shareholders, on the other hand, generally expect to receive a higher total return (dividend plus capital growth of share value) on their equity funding than providers of debt funding. The level of dividend depends on the commercial success of the company and on the discretion of the directors. The rate of share value growth depends upon the company's overall actual and projected success. Debt is commonly considered a cheaper (ie its cost in terms of interest, versus dividend plus share value appreciation) but less flexible form of corporate funding than equity funding.

In this chapter, the focus is on *secured* debt, looking at options that are used by small and large companies alike (with the exception of use of the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226) and subsequent amendments, which are beyond the scope of this book[1]). But some general comments are warranted first. Like any other legal person, a company may borrow money, subject to any restrictions in its constitution.[2] There are, however, a number of special features of corporate borrowing that are worth noting.

(i) To raise very large sums of money, a company may wish to attract funds on the investment market, that is, to borrow from very many lenders at once, or in sequence, all on the same terms. The mechanics of such a procedure are not greatly different from those involved in making an issue of shares, and indeed such issues may (but need not) be traded on the Stock Exchange subject to the same rules as equivalent dealings in equity securities (see Notes following, p 596). The investors will become a class of *creditors* of the company rather than *members* of the company; and the *debentures* (or more often *bonds*, in Europe and the United States, and increasingly here) held by each creditor will be *marketable securities*. The theoretical differences between being a creditor and a member are considerable, from a legal point of view, but (at least in the case of a solvent and prosperous company) the practical consequences (including, often, the total returns, ie interest plus capital appreciation) for investors, apart sometimes from tax considerations, may be very similar.

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(ii) Where numerous investors advance money to a company in this way, it is usual for their rights to be regulated by a debenture trust deed, under which trustees are appointed to represent the investors as a class vis-à-vis the company. In the trust deed, provision is made for the collective views of investors to be ascertained by votes taken at meetings, with the usual apparatus of proxies, etc. Recall that where creditors vote as a class, the majority is prohibited from voting in ways which oppress the minority, just as shareholders are restrained: see *British America Nickel Corpn Ltd v O'Brien* **[11.06]**; *Asségnagon Asset Management SA v Irish Bank Resolution Corporation Ltd (Formerly Anglo Irish Bank Corporation Ltd)* **[11.07]**; cp *Azevedo v Imcopa Importacao Exportaacao e Industria de Oleos Ltda* [2013] EWCA Civ 364. Two basic arrangements are common. In the first, each investor lends to the company directly, and simultaneously agrees to be bound by the terms of the trust deed in his dealings with the company. In the second (which is the more usual form in modern practice), all the loans are consolidated into one fund and the aggregate sum is advanced to the company by the trustees, who alone stand in a contractual relationship with the company: each investor then subscribes for so much 'debenture stock' or 'loan stock' out of the fund. Creditors can realise their investments strictly according to the terms of the debenture, or, if the debentures are marketable securities, by trading on the market. The ability to trade has advantages for creditors (increased liquidity and potentially higher total returns), and for the company (the loan repayment dates are certain, and not affected by creditors wanting early repayment).

(iii) A company can give security for its obligations, just like any other legal person. Where a company *charges* its property to secure an obligation to a creditor (not necessarily, of course, a borrowing obligation), CA 2006 may require that particulars of the charge to be *registered* under the provisions of Pt 25 (ss 859Aff), failing which the security will be for many (but not all) purposes void: see 'Requirement to register charges', pp 601ff.

(iv) A company has the ability, not enjoyed by an individual in English law,[3] to create a '*floating charge*' over assets such as stock-in-trade and book debts,[4] which may fluctuate from time to time, on terms that the company remains free to deal with them in the ordinary course of business: see 'Fixed and floating charges: definitions', pp 605ff.

(v) When a company makes default in any of its obligations under the document creating a charge, or when the security it has created is in jeopardy, the company's obligation is normally enforced by the appointment by the creditors (or the trustee for such creditors in the case of a debenture trust deed) of a *receiver* to look after the secured creditors' interests: see 'Receivership and administrative receivership', pp 778ff. Alternatively, where the charge is floating, changes to the statutory regime now ensure that *administration*, rather than administrative receivership,[5] is increasingly the norm (see 'Administration', pp 770ff).

(vi) Borrowing transactions secured by a floating charge may raise special questions in a *winding up*: see 'Different protections afforded to fixed and floating charge holders', pp 600ff, (p. 596) indicating the relative disadvantages of floating charges over other forms of security in providing protection to the security holder.

➢ Notes

1. It is apparent from the earlier commentary that an investment in debentures or debenture stock is very similar to an investment in shares: both are 'securities' in the corporate sector of the economy offering different kinds of risk and different kinds of return. Many companies have their debentures or debenture stock listed for dealing on the Stock Exchange. These securities are transferred in the same way as shares, with companies maintaining registers of debenture holders alongside their registers of members.

2. The form of the prospectus required for debt securities is prescribed in Regulation (EC) 809/2004. This distinguishes between the retail market (intended for the general public) and the wholesale market (intended for professional investors). The distinguishing criterion is the nominal value of the securities: those with a nominal value of less than €50,000 are regarded as intended for the retail market. And by Directive 2003/71/EC (Art 3(2)(c)), no prospectus is required for a public offer of wholesale debt securities (traded on the Professional Securities Market).

3. Under the CA 2006 s 616, companies are no longer able to use their share premium account to write off any expenses incurred, commission paid or discount allowed in respect of an issue of debentures or in providing for the premium payable on a redemption of debentures.

4. Major companies may also raise money by the issue of 'bonds', commonly referred to as 'Eurobonds' or 'international bonds' (a form of bearer security), which are usually denominated in a currency other than sterling and, because they are for large amounts, will be bought and dealt in by banks and other institutional investors rather than the general public. There are various international markets and securities exchanges for dealings in such bonds.

> ➢ Questions
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> 1. List some of the points of similarity and difference between shareholders and debenture holders which follow from the fact that a shareholder is a *member*, while a debenture holder is a *creditor*, of the company. Think of:
>
> **(i)** the right to income;
> **(ii)** application of the 'maintenance of capital' rules;
> **(iii)** the right to return of capital during the lifetime of the company;
> **(iv)** the right to return of capital in a liquidation;
> **(v)** taxation;
> **(vi)** voting.
>
> 2. Some of these points may be varied by the terms of issue of the share or debenture, for example a share *may* carry no vote, a debenture holder *may* be given a vote in some circumstances. Which of the points listed earlier may be varied in this way?

Debentures

Definitions.

CA 2006 s 738

> 738 In the Companies Acts 'debenture' includes debenture stock, bonds and any other securities of a company, whether or not constituting a charge on the assets of the company.

(p. 597) [12.01] Levy v Abercorris Slate and Slab Co (1887) 37 Ch D 260 (Chancery Division)

The facts are immaterial.

> CHITTY J: In my opinion a debenture means a document which either creates a debt or acknowledges it, and any document which fulfils either of these conditions is a 'debenture'. I cannot find any precise legal definition of the term, it is not either in law or commerce a strictly technical term, or what is called a term of art.

An instrument may be a debenture although it is not under seal and gives no security to creditors for the company's obligation.

[12.02] British India Steam Navigation Co v IRC (1881) 7 QBD 165 (Queen's Bench Division)

The company had issued instruments described on their face as 'debentures', by which the company undertook to pay the holder £100 on 30 November 1882, and to pay interest half-yearly at 5% per annum. It was argued unsuccessfully that the instruments, not being under seal, came within the definition of a promissory note and so did not attract the higher rate of stamp duty ordinarily payable on debentures.

> LINDLEY LJ: Now, what the correct meaning of 'debenture' is I do not know. I do not find anywhere any precise definition of it. We know that there are various kinds of instruments commonly called debentures. You may have mortgage debentures, which are charges of some kind on property. You may have debentures which are bonds; and, if this instrument were under seal, it would be a debenture of that kind.

You may have a debenture which is nothing more than an acknowledgment of indebtedness. And you may have a thing like this, which is something more; it is a statement by two directors that the company will pay a certain sum of money on a given day, and will also pay interest half-yearly at certain times and at a certain place, upon production of certain coupons by the holder of the instrument. I think any of these things which I have referred to may be debentures within the Act.

[His Lordship accordingly held that the instrument was a debenture and liable to be stamped as such.]

➢ Note

The term 'debenture' is capable in law of having a very wide meaning—it is simply a document evidencing a debt of any kind. But both in commercial usage and in the layman's understanding, it is commonly understood to refer to a document evidencing some *secured* obligation, and so the Listing Rules require that any issue of unsecured debentures be specifically denominated 'unsecured', and indeed it is more common for the word to be avoided altogether in this situation and a term such as 'loan stock' or 'loan notes' used instead.

Debentures and debenture stock may be issued in bearer form (ie not requiring registration for legal effect), and may also be created on terms which make them negotiable instruments: *Bechuanaland Exploration Co v London Trading Bank* [1898] 2 QB 658. As regards convertible debentures, see 'Issue of debentures at a discount', p 506.

Secured debt: mortgages, fixed and floating charges

Many companies will need to provide security for the repayment of their funding obligations, and not only obligations by way of loan. Only the largest companies, invariably trading on the **(p. 598)** London Stock Exchange or some other national equivalent, can avoid this. Since the issue is so common, and so important, the rest of this chapter is devoted to examining the rules relating to corporate security, especially fixed and floating charges. First, though, some definitions of the types of interests used to provide security.

Mortgages

A mortgage is a security interest created by transfer of legal title in the secured asset from the borrower/mortgagor to the lender/mortgagee. The borrower has an '*equity of redemption*', allowing recovery of legal title once the secured obligation is fulfilled (eg the loan, interest, etc repaid) and, in the meantime, the lender has the right to take possession, and perhaps even to foreclose if permitted by court order, if the borrower defaults.

Historically, purchases of real property were secured by mortgages of this type over the land being bought. Now, however, the legal title to the land is *not* transferred to the lending bank (or other mortgagee), and the bank merely takes a legal *charge* over the property. (Nevertheless, we continue to speak of mortgages over land, and describe buyers as mortgagors and banks as mortgagees.) This charge over land is anomalous only in the sense that it is a *legal* charge, created by statute (Law of Property Act 1925 ss 85–87), whereas the charges discussed in this chapter are all necessarily *equitable*, not legal.

Charges

A *charge* is a security interest created in or over an asset or assets by their owner (the '*chargor*') in favour of a creditor (the '*chargee*'), by which it is agreed[6] that that property shall be appropriated to the discharge of a debt or other obligation. There is no transfer of title. The chargee's rights are proprietary, but created by contract, and only for real consideration (since this is in equity, a deed for no consideration will not do: see *Re Earl of Lucan* (1890) 45 Ch D 470). The chargee's right may be enforced by the sale of the property, if necessary by court order; but in practice most security documents expressly empower the chargee to sell the property for this purpose without recourse to the court (See Slade J in *Re Bond Worth Ltd* [1980] Ch 228, 250.). Legal charges are possible over some forms of property, such as land (see earlier), but not over personalty. The charges discussed in this section are all equitable charges.

Fixed charges

All charges are either fixed or floating. A fixed charge (or 'specific' charge) is a charge created over identified property which restricts the debtor's power to dispose of or otherwise deal with the property without the creditor's consent. It is not necessary that the property should be presently owned by the chargor: future property may be the subject of an agreement to charge, provided that it is sufficiently well described to be identifiable when acquired. The effect of such an agreement, if for value consideration, is that a charge is deemed to come into existence as soon as the property is acquired by the chargor (*Holroyd v Marshall* (1862) 10 HL Cas 191).

Floating charges

A floating charge also requires the property affected to be identified, in the same sense, but it is of the essence of a floating charge that it contemplates that the chargor will be free to deal with the charged property in the ordinary course of business without reference to the chargee (sometimes called the 'trading power'). The floating charge thus allows a company to give **(p. 599)** security over assets which are continually turned over or used up and replaced as a matter of routine trading. This is an enormously valuable invention, devised by equity draftsmen in the latter part of the nineteenth century, founded upon the agreement of the parties and owing nothing to legislation—rather like the device of hire-purchase which evolved at about the same time.[7] What successive Companies Acts and Insolvency Acts have done since its creation is to adopt a variety of rules designed to restrict the full power of its impact, which is potentially to sweep up *all* the company's resources (by securing '*the undertaking*' or '*all the assets and undertaking*' of the company) and dedicate them to securing the debt of *one* of the company's creditors,[8] leaving all the others unprotected, unable even to share *pari passu* in the company's resources on a winding up.

The significance of the floating charge lies in the fact that, for many businesses, fluctuating assets such as stock-in-trade, raw materials and book debts may form a significant part of the property of the concern, and may be the only worthwhile security available for an advance. Indeed, the proprietors of an unincorporated business which is in need of finance may find themselves compelled to form a company if they are to raise the loans they are seeking: hence the ability to grant a floating charge can be an important consideration in deciding whether or not to trade in the corporate form. Banks, in particular, have wide experience of the floating charge and encourage its use by their clients.

The nature of a charge.

[12.03] National Provincial Bank v Charnley [1924] 1 KB 431 (Court of Appeal)

The facts are immaterial.

> ATKIN LJ: It is not necessary to give a formal definition of a charge, but I think there can be no doubt that where in a transaction for value both parties evince an intention that property, existing or future, shall be made available as security for the payment of a debt, and that the creditor shall have a present right to have it made available, there is a charge, even though the present legal right which is contemplated can only be enforced at some future date, and though the creditor gets no legal right of property, either absolute or special, or any legal right to possession, but only gets a right to have the security made available by an order of the Court. If those conditions exist I think there is a charge. If, on the other hand, the parties do not intend that there should be a present right to have the security made available, but only that there should be a right in the future by agreement, such as a licence, to seize the goods, there will be no charge …

Debenture holders' remedies and the protection afforded by charges

We have not yet examined the approach the courts adopt in determining whether the security the parties have created is effective, and if so whether it is fixed or floating in form. However, in large measure the reason for the efforts in that direction are because a valid security **(p. 600)** delivers particular protections to the security holder. It is helpful to be aware of what those are before descending into the detail of the analysis required to establish the nature and effectiveness of the security itself.

Any creditor whose debt is unsatisfied may, of course, sue to recover payment, and may also seek to have the company wound up if it fails to meet a statutory demand for payment (IA 1986 ss 122(1)(f) and 123(1)(a): see 'Grounds for compulsory winding up', pp 792ff). But secured creditors also have recourse to their security. Where the charge affects specific property, powers of sale and of entry into possession may be exercised by the secured creditor personally, although usually the creditor will appoint a professional third party as a *receiver*. This may always be done by obtaining a court order; but almost invariably the need to go to court will be obviated by the inclusion in the instrument creating the charge of a clause empowering the creditor itself (or the trustees, where there is a trust deed) to appoint a receiver in the event of default. Note, however, that if the charge is a floating charge secured over the whole or substantially the whole of the company's property, then the holder may no longer appoint an administrative receiver (IA 1986 s 72A), subject to certain limited exceptions in IA 1986 ss 72B–72EA, but must instead appoint an *administrator* who has defined objectives in dealing with the company's assets.

The subject of receivers, including administrative receivers, is discussed further at 'Receivership and administrative receivership', pp 778ff.

If the borrowing company is insolvent (ie unable to pay all its debts in full), then security affords secured creditors priority in repayment of their debts. Basically, the secured assets are used first to fund repayment of the secured debt, and only then are any remaining assets used to repay all or a pro rata part of the debts owed to the unsecured creditors. If a company owes £100,000 to a secured creditor and £100,000 to its unsecured creditors, for example, and its assets are only worth £100,000, then those assets (assuming these are the assets over which security has been taken) will go entirely to repaying the secured debt, and the unsecured creditors will get nothing. In practice, the statutory rules are more sophisticated and more complicated, but this gross generalisation is fundamentally true. The statutory rules are considered in detail in Chapter 16.

Being secured is obviously advantageous, but, in addition, the advantages afforded to holders of fixed charges are substantially greater than those afforded to holders of floating charges, as described next.

Different protections afforded to fixed and floating charge holders

The distinction between fixed and floating charges has important consequences. These charges are treated differently during the term of the security, during receivership and on the insolvency of the debtor. For example, with floating charges (but not with fixed charges):

(i) the chargor can legitimately deal with floating charge assets in the ordinary course of business (until an event of default that causes the charge to *crystallise*—see 'Crystallisation of floating charges', p 614), so the value of the security may be depleted before the chargee calls on it;
(ii) prior to the 6 April 2013 amendments, it used to be the case that all floating charges needed to be registered, but not all fixed charges (see CA 2006 s 860 as it was, and now s 859A and 'Requirement to register charges', p 601);
(iii) a floating charge is subordinated to the costs and expenses of administration and liquidation (see IA 1986 Sch B1, paras 70 and 99, and IA 1986 s 176ZA; and 'Administration', pp 770ff and 'Liquidation or winding up', pp 788ff);
(iv) an administrator can dispose of assets subject to a floating charge without first obtaining court approval (IA 1986 Sch B1, paras 70–71, and 'Powers and duties of the administrator', pp 774ff);
(p. 601) **(v)** preferential creditors rank ahead of the floating charge holder in their call on assets subject to the floating charge (IA 1986 ss 40 and 175(2)(b); Sch B1, para 65(2); and Sch 6, paras 8–12: see 'Distribution of assets subject to the receivership', pp 787ff);
(vi) on insolvency, a statutory proportion of floating charge realisations must be set aside for the unsecured creditors (see IA 1986 s 176A, and 'Distribution of assets subject to the receivership', pp 787ff);
(vii) a floating charge created for no new value in the period immediately leading up to insolvency may be set

aside (IA 1986 s 245). No equivalent exists for fixed charges, which can only be set aside if they involve a preference (IA 1986 s 239). See 'The Liquidator's ability to "claw back" property-unwinding transactions', p 806.

Requirement to register charges

Statutory requirements

Part 25 of CA 2006 imposes on companies a statutory obligation to register particulars of charges which they have created over their property. Following a long history of failed attempts at reforming the law in this area (see later), the existing rules have finally been modified, although perhaps not greatly, with the aim of delivering a more modern regime which will save time and cost for those using it. The Department of Business, Innovation and Skills suggests the cost savings could be of the order of £22 million per annum.[9] The reforms were made by way of the Companies Act 2006 (Amendment of Part 25) Regulations 2013,[10] which repealed CA 2006 Pt 25, Chs 1 and 2, replacing them with Ch A1, which came into force on 6 April 2013.

This requirement to register charges was first imposed by the Companies Act 1900. Up until the 2013 changes, the approach adopted was to list the types of charges which were required to be registered. Not every category of charge was affected—fixed charges over shares or negotiable instruments, for instance, escaped the net—although the list was always fairly comprehensive, and included all floating charges. Under the new rules, there is no longer a prescribed list. On the contrary, s 859A quite simply states that the section will apply 'where a company creates a charge', subject only to three exceptions set out in s 859A(6). The hope is that this will reduce the uncertainty surrounding which charges must be registered. Section 859B provides parallel provisions for charges given to support a series of debentures. But note that it is only charges*created by the company* which come within Pt 25: a charge created by operation of law, such as an unpaid vendor's lien over land which is the subject of a contract of sale, is outside the scope of the Act.

For every charge created by a company, CA 2006 s 859A does not make it mandatory for the parties to register the charge (as the previous rules had, with criminal sanctions to back up the rule), but instead compels the registrar to register the charge *if* the parties deliver the appropriate instruments and details to the registrar within the specified time (basically 21 days, but see ss 859E and 859F). Either the company or the charge holder (or 'any person interested in the charge', s 859A(2)) may see to the registration, and would be well advised to do so if there is any risk that the company will default. The change from compulsion to permission may be immaterial, however, as the consequence of failure to register is that the **(p. 602)** charge is void on precisely the occasions when it is most needed: see 'Effect of failure to register', p 602.

If a company acquires property which is already subject to a charge, particulars of the charge may similarly be delivered for registration (s 859C).

Where the charge (eg a charge over land or a ship) requires registration under other legislation, that does not provide a reason for non-compliance with CA 2006 Pt 25, unless the other Act excludes the application of the CA 2006 provisions (see s 859A(6)).

Certificate of registration

On registration, a certificate is issued which must state the unique reference code allocated to the charge (s 859I(4)). Under s 859I(6), the certificate is 'conclusive evidence that the documents required by the section concerned were delivered to the registrar before the end of the relevant period allowed for delivery.'

This is far more specific than its predecessor, which simply stated that the certificate was 'conclusive evidence that the requirements of this Chapter as to registration have been satisfied'. Earlier cases suggested the force of the certificate—and of the register—was assured even where the certificate was inaccurate (*Re Mechanisations (Eaglescliffe) Ltd* [1966] Ch 20), or the facts on which the certificate was based were untrue (eg where the charge instrument is falsely dated: *Re CL Nye Ltd* [1971] Ch 442), or the charge was registered by mistake (*Ali v Top Marques Car Rental Ltd* [2006] EWHC 109 (Ch)). The effect was that notwithstanding that the details on the register were incorrect, and people inspecting the register would be misled, the certificate would be conclusive proof that the statutory requirements had been met. As a consequence, the *actual* charge as created by the company would be deemed to be duly registered, and would have to be observed by the company's creditors and its liquidator or administrator, notwithstanding creditors who may have been misled as to the company's true position. And because the certificate was conclusive evidence that the requirements had been met, it was impossible to have proceedings for judicial review of the registrar's decision.

Despite all this, the conclusiveness of the certificate was seen as a crucial benefit of the registration system, and a proposed downgrading of it was in large measure the reason for the unpopularity of certain proposed 1989 reforms. The new rules seem to have worked around this.

Effect of failure to register

If particulars are not registered within 21 days of the creation of the charge (a date defined in s 859E, attempting to provide for both English and Scottish securities), or such longer period as allowed by the court (s 859F, see the following section), then CA 2006 s 859H declares the *security* to be void against the liquidator, administrator and any creditor of the company[11] (s 859H(3)), although the personal obligation remains and, indeed, the money secured becomes immediately payable (s 859H(4)).

(p. 603) The nature of this sanction of 'partial voidness' should be noted. First, it is only the *security* that is avoided, not the underlying obligation, which remains good as an unsecured debt. Secondly, the charge is void only as against the persons mentioned and not, for instance, *inter partes*, or against an execution creditor. And the chargee may dispose of the property in exercise of a power of sale and give a good title to the purchaser, even though the charge is 'void'.

Extension of the registration period and rectification of the register

CA 2006 s 859F enables applications to court to extend the 21-day registration period. The court may make whatever orders it sees as just and expedient provided certain pre-conditions are satisfied (s 859F(2)), including that it is just and equitable to grant relief. This replicates predecessor rules, so see *Barclays Bank plc v Stuart Landon Ltd* [2001] EWCA Civ 140, CA, for a discussion of the factors to be considered by the court when dealing with an application for late registration of a charge created by a company which was close to liquidation.

In analogous circumstances, and subject to the same conditions, s 859M enables the court to make an order rectifying the register where there has been an omission or mis-statement, and s 859N provides the court with a discretion to replace the instrument or debenture where there has been an omission, mistake or defect.

Registration, priority and constructive notice of registered charges

Registration does not of itself confer priority or give any protection to a charge holder, although of course, as noted previously, non-registration has almost fatal consequences for the security. Instead, priority as between different charges over the same property is determined by the ordinary rules of law. Thus, for example, a legal charge will normally have priority over an equitable charge, a fixed charge over a floating charge (because of their terms) and, as between two equitable charges, the earlier in time will prevail. So, if a company were to create a charge in favour of A on the first of the month, and then give an identical charge over the same property to B on the 10th, registering particulars on the 15th, B (who had searched the register on the 10th and found it clear) could in all innocence believe that he has a first charge, only to discover later that A has a charge which ranks ahead of his own, so long as it has been registered within the statutory 21 days. B is deemed to have notice of the earlier charge provided A files for registration within the statutory 21-day period. (This is referred to in the Company Law Review (CLR) as 'the 21-day invisibility problem'. It could be eliminated if 'notice filing' were introduced, although even then there could be a gap between the time when a document is delivered to Companies House and the time when it is recorded on the register.)

The doctrine of constructive notice has not been abolished in regard to particulars of charges held by the registrar, and so everyone dealing with a company is deemed to have notice of those particulars which are required by statute to be registered.[12] These are defined in s 859D, and include the date of creation of the charge, the nature of the charge (fixed or floating), the amount secured, short particulars of the property charged, and the persons entitled to the charge, and, by way of change from the earlier rules, whether the charge includes a 'negative pledge' clause (ie a provision by which the company undertakes not to create other charges ranking in priority to or *pari passu*with the charge; see s 859D(2)(c)).

This change in the rules on negative pledges eliminates the problem illustrated in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, Ch (overruled in*Spectrum* **(p. 604) [12.20]**, but not on this issue). Under the predecessor rules, details of negative pledges were not mandatory, but a practice developed of including such details in the registered particulars. In *Siebe Gorman*, it was held that the constructive notice doctrine did not extend to such additional information, but only to those matters which the Act prescribed, and so a searcher would be taken to know of such a clause only if he had *actual* notice of it. The point always remained controversial, with little persuasive authority or argument.[13]

Section 859L contains provision for entering on the register a 'statement' that the debt secured by a charge has been satisfied or some or all of the property charged has been released from the security. But there is no obligation to register this information under the existing law.

Company's own register of charges

Under the old rules, the company itself was also required to keep a register of charges. Since this register was required to cover every kind of charge, not only those which were registrable, the obligations were potentially very burdensome. They were also largely pointless, since neither the validity of the charge nor any question relating to priority was affected by a failure to observe these requirements, and in practice the related criminal sanctions were never invoked. This may explain why the new rules no longer require companies to keep their own registers, but merely demand that companies keep copies of the full instruments available for inspection (s 859Q).

Further reform of the registration system

The need for some sort of registration system is almost universally accepted, but the present system, which has changed little for over a century, despite the various 2013 changes, has long been thought to be deficient. Almost 25 years ago, changes were made to the Companies Act 1989 that were intended to sweep away the old law and replace it with a completely new regime containing provisions which would reduce the burden on Companies House but at the same time give rather less protection to persons who relied on the registration system. Those proposed reforms met with such opposition from business and professional circles that the government was dissuaded from bringing the regime into operation. Instead, a consultation process was begun which envisaged retaining the earlier CA 1985 provisions, but introducing some modifications. That idea was subsequently overtaken by the decision to set up the CLR, which published its own consultation document seeking views on possible ways forward. Following that, the Law Commission was asked to examine the whole of the law on the registration, perfection and priority of company charges, and to consider the case for a new registration system. It was also asked to consider whether such a system should be extended to quasi-securities (retention of title agreements, etc), and to securities created by individuals as well as companies.

The Law Commission, looking to have changes included in CA 2006, made various recommendations, including adoption of a notice-filing system (see later) for company charges (see *Company Security Interests* (Law Com No 296, 2005)). The government then issued a further consultation document (*The Registration of Companies' Security Interests (Company Charges): The Economic Impact of the Law Commissions' Proposals*, 2005). This received a rather negative response, and so all the issues were parked, subject to still further discussions and deliberations before any decision could be taken on what ought to be done. The latest 2013 reforms fall far short of counting as movement on this front. Their biggest changes are simply the elimination of the list of registrable charges in favour of making all charges registrable, and also including public notification on the register of negative pledge clauses.

(p. 605) This rocky road to reform might be seen as both surprising and disappointing. Both the Crowther Committee (which was concerned with reform of the law on consumer credit: Cmnd 4596, 1971) and Professor Diamond in his report (*A Review of Security Interests in Property* (1989)) categorically recommended that this country should follow the lead of the United States and Canadian jurisdictions in setting up an entirely new system of registration for all personal property security interests, whether created by individuals or companies, on the model of Art 9 of the American Uniform Commercial Code. This would make a separate regime for company charges unnecessary. The same conclusion was reached independently by reform bodies in other Commonwealth jurisdictions, such as Australia and New Zealand—each of which has now implemented this major change. But, sadly, there seems to be little enthusiasm for any such reform in the UK, despite the most recent consultation responses in its favour.[14]

What is different about these other regimes? Article 9 of the Uniform Commercial Code is at the same time a more comprehensive system and yet a simpler and more flexible one: it governs all transactions which *in effect* create a security, whatever their form (including, eg, hire-purchase agreements and sales on retention of title (*Romalpa* **[12.21]** terms), and works on the principle of 'notice filing'. Priority as between competing registered securities is governed simply by the time of filing of the notice of such security: the security filed first has priority over all that follow. It gives better protection—first, for security holders, in that registration confers priority over others who may claim interests in the same property; secondly, for those intending to take security who, by filing a notice, can cover their position provisionally until the security is completed or the charge attaches; and, thirdly, for those seeking to rely on searches of the register, who can take the record at its face value.

Fixed and floating charges: definitions

The preceding sections described the structure of the regime for company securities. It is now appropriate to look at the nature of the securities themselves. Recall that charges may be over present or future property and can be either fixed or floating. A *fixed* (or 'specific') charge is one which restricts the debtor's power to dispose of or otherwise deal with the specific property charged, without first obtaining the creditor's consent. A *floating* charge, on the other hand, permits the debtor the freedom to deal with the charged property in the ordinary course of business without recourse to the creditor for approval. This liberty to deal with the charged assets continues until the floating charge *crystallises* into a fixed charge. The parties can nominate in the charge document the conditions, or time, at which this will happen. Additionally, the charge will crystallise by operation of law if the debtor company ceases to carry on business for any reason (see 'Crystallisation of floating charges', pp 614ff).

The distinction between fixed and floating charges is completely irrelevant in assessing the rights, as between the company (chargor) and the lender (chargee) arising under the charge; these are determined by the charge document. The distinction is critical solely because various statutory rules relating to validity and priority are worded to apply to one form of security but not the other: see 'Different protections afforded to fixed and floating charge holders', p 600.

(p. 606) Categorisation of a charge as fixed or floating is based on the *substance* of the arrangement between the parties, not on the label they attach to their arrangement.[15] The following cases indicate the process adopted by the courts in making this determination.

[12.04] Agnew v Commissioner of Inland Revenue (Re Brumark Investments Ltd) [2001] UKPC 28, [2002] 2 AC 710 (Privy Council)

The facts and a longer extract appear at **[12.19]**.

> LORD MILLETT: 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.

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.

Also see the *Spectrum* decision at **[12.20]**.

[12.05] Illingworth v Houldsworth [1904] AC 355 (House of Lords)

This is the appeal to the House of Lords of the decision in *Re Yorkshire Woolcombers Association*, cited by Lord Millett at **[12.04]**.

EARL OF HALSBURY LC: 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 [the security] should carry with it the book debts [the charged assets] which were then existing, but it contemplates also the possibility of those book debts being extinguished by a payment to the company, and that other book debts should come in and take the **(p. 607)** place of those that had disappeared. That … seems to me to be an essential characteristic of what is properly called a floating security …

LORD MACNAGHTEN: 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 …

[12.06] Evans v British Granite Quarries Ltd [1910] 2 KB 979 (Court of Appeal)

The facts are immaterial.

BUCKLEY LJ: A floating charge is not a future security; it is a present security which presently affects all the assets of the company expressed to be included in it … 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 it is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some act or event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security …

[12.07] Re Bond Worth [1980] 1 Ch 228

The case concerned an unsuccessful attempt to give a supplier of goods the benefit of a retention of title clause (discussed at 'Retention of title agreements', pp 632ff).

SLADE J: There is, however, one type of charge (and I think one type only) which, by its very nature, leaves a company at liberty to deal with the assets charged in the ordinary course of its business, without regard