charge in favour of the debenture-holders.

I consider that it did.

The relevant clauses and conditions of the debenture have already been referred to … There is under clause 3 a charge on all future assets of the company without restriction: that amounts to an agreement for valuable consideration to charge all such future assets, which agreement enables equity to fasten a charge on those future assets when they arise: and every such equitable charge as it arises operates as an equitable assignment to the debenture-holders of that asset … The fact that [the floating charge has crystallised and is now fixed]… in no way justifies the conclusion that the field of the charge is in any way restricted: it only means that after this particular quality disappears equity will fasten the charge directly upon all assets thereafter coming into existence as soon as they do so …

If that be a correct view of the construction of the debenture, then the choses in action consisting of the debts now sued upon became as they arise subject to an equitable charge—an equitable assignment—to the debenture-holders …

Thus far, in my judgment, by force of the debenture charge an equitable charge attached in favour of the debenture-holders not only on the £95 debt existing at the date of the appointment of the receiver and manager, but also upon the other debts constituting the total of £1,346 as they came into existence on delivery of goods to the defendants after such appointment. These choses in action belonging to the company became thus assigned in equity to the debenture-holders, at times when the defendants had no cross-claim of any kind against the company and consequently no right of set-off. Before the defendants acquired by assignment this cross-claim the defendants must be fixed with knowledge of this equitable assignment to the debenture-holders (by way of charge) of the debt owed by the defendants to the company. A debtor cannot set off his claim against X against a claim by X against him which the debtor knows has been assigned by X to Y before the debtor's claims arose. Just as an assignee of a chose in action takes subject to an already existing right of set-off, so a debtor with no existing right of set-off cannot assert set-off of a cross-claim which he first acquires after he has notice of the assignment of the claim against him: here, for instance, no part of the £852 could have been set off against the £95.

Applying these considerations to the present case, at the time when the defendants first acquired the claim for £852, the choses in action sought to be enforced against the defendants had been assigned to the debenture-holders by way of charge, but the £852 claim in no way involved the debenture-holders …

SELLERS LJ delivered a concurring judgment.

DONOVAN LJ dissented.

(p. 618) ➤ Question

Contrast this case with the *Biggerstaff* case **[12.11]**, and also see *Rother Iron Works Ltd v Canterbury Precision Engineers Ltd* [1974] QB 1, CA. What is the essential difference that explains the contrasting outcomes?

Priorities as between the floating charge, even after crystallisation, and other interests are determined by the usual rules.

[12.15] George Barker Ltd v Eynon [1974] 1 WLR 462 (Court of Appeal)

The case concerned a priority dispute between the holder of a contractual lien and the holder of a floating charge. The claimants had a contractual lien over the goods of a meat-importing company whose indebtedness to a bank was secured by a mortgage debenture creating a floating charge. The debenture holder's rights crystallised on the appointment of a receiver, but the Court of Appeal held that the lien took priority because the contractual rights arose even earlier, before the appointment of the receiver and so before crystallisation of the charge. This was notwithstanding that the claimants did not acquire actual possession of the goods until three days after the receiver's appointment.

> STAMP LJ:… Shorn of the arguments supporting it, the receiver's contention before this court was that this is a case of priorities. The lien was a possessory lien which did not come into existence until the carriers were in possession of the goods. Before the carriers came into possession of the goods the charge in favour of the debenture holder crystallised by the effect of the appointment of the receiver. The goods had become the subject of an equitable assignment to the debenture holder and the lien could not come into existence as against the debenture holder.
>
> These submissions are not, in my judgment, well founded. What is in law described under the convenient label of a 'lien' is in relation to a carrier … the contractual right to hold the goods which have been carried in respect of the debt for the carriage and in respect of the debts of the same character previously contracted. The duty of the carriers here was to carry the goods and deliver them, or they might say after they had carried them, 'We will hold these goods in exercise of the right to do so conferred by the contract of carriage until we have been paid,' and they might say, 'Moreover, we will, unless we are paid within a reasonable time, in exercise of our right under the contract, sell the goods and pay ourselves out of the proceeds. These are the terms upon which we carried the goods.' In my judgment, these rights did not arise or come into existence at the time the carriers took possession of the goods … The rights were rights created by the contract which became exercisable at the moment of time when the goods had been carried. The rights which were conferred on the carriers by condition 13 of the contract are conveniently and accurately described as a 'lien,' but you do not by so describing them alter their character. They are conveniently described as 'a possessory lien,' because it is only if the carriers have possession that they can be exercised. But to say that a lien, because it is so described, does not come into existence until possession is assumed is to reason falsely. Contractual rights come into existence at the time of the contract creating them notwithstanding that they may not be exercisable except upon the happening of a future event …
>
> There was nothing remarkable about the contract. It was simply a contract for the carriage of goods incorporating the Conditions of Carriage of the Road Haulage Association. It was, in my judgment, clearly a contract into which, so long as the charge created by the debenture was a floating charge, the company could, consistently with the terms of the debenture, properly enter into. It was, as I have indicated, a contract which was not determined by the effect of the appointment of the receiver. The receiver might, so I will assume, have repudiated it before the carriers started the journey, so preventing the carriers obtaining possession of the goods and carrying out their obligations under it. He did not do so. How then could the receiver or the debenture holder as assignee of the goods and of the rights of the company under the contract be in any better position than would the **(p. 619)** company have been to insist at the end of the journey that the goods be handed over without making the payments for which condition 13 provided? In my judgment, Mr. Tugendhat was right in his contention that the assignment to the debenture holder brought about by the appointment of the receiver was subject to the rights already given by the company to other persons under ordinary trading contracts. As against the company, the carriers on arriving at the door of the consignees at Gravesend could have withheld the goods against payment, and in my judgment, the debenture holder as assignee from the company can be in no better position. The debenture holder as assignee of the company's rights under the contract can be in no better position than any other assignee of the company's rights under the contract …

Treatment of floating charges on the company's liquidation

The point has already been made that floating charges can be a vulnerable form of security. Certain statutory provisions cut down the effectiveness of the floating charges on liquidation or administration, by giving priority to other debts (eg the costs of liquidation and administration, preferred debts and unsecured debts (at least to the extent of a statutory proportion of the floating charge assets)): the statutory provisions are noted at 'Debenture holders' remedies and the protection afforded by charges', pp 599ff, and their effect is considered in more detail in

Chapter 16.

In addition, IA 1986 s 245 avoids certain floating charges not given for 'new consideration' in the run-up to liquidation or administration. The intention is to prevent unsecured creditors from securing existing debts when the company is in difficulty, and thus obtaining an advantage over other unsecured creditors. IA 1986 s 245 provides that, subject to certain qualifications, a *floating* charge (not a *fixed* charge) that is created within 12 months of a liquidation or an administration shall be invalid except to the extent that the charge holder advances 'new money' or supplies goods or services to the company. This rule does not apply, at least in the normal case, if it is shown that the company immediately after the creation of the charge was solvent. But stricter conditions are applicable where the floating charge is given in favour of a person who is 'connected' with the company (see IA 1986 s 435, including, eg, a director or major shareholder, or a close relative of either, or an associated company). In this case the 12-month period is extended to two years, and the exemption on the ground of solvency is not available.

A floating charge which has already been redeemed cannot be attacked under IA 1986 s 245, but the payment of the debt may be open to challenge as a preference.

[12.16] Re Parkes Garage (Swadlincote) Ltd [1929] 1 Ch 139 (Chancery Division)

On 15 June, the (insolvent) company executed a floating charge to secure debts owed to a group of its creditors. On 27 July, the company received a sum of money from the purchaser of part of its business, and used this sum to pay off the group of creditors, who endorsed a memorandum of discharge on the debenture. On 14 September, a winding-up order was made on the petition of another creditor. It was held that the then equivalent of IA 1986 s 245 could not be invoked to compel repayment of the moneys once the debenture had been redeemed, but the court indicated that it was open to the liquidator to challenge the transaction as a fraudulent preference.[23]

> EVE J: Having regard to the facts which I have stated, about which there is no dispute, it is quite obvious that the learned county court judge had no option but to declare the charge to be invalid, **(p. 620)** and he so did. That part of his judgment, however, was not of much practical importance, because the charge had been satisfied by the payments which had been made, and it was then argued that the declaration of invalidity involved the further question: whether the debenture was still subsisting for any purpose, and if so were the simple contract debts, to secure which it had been issued, merged in the covenant contained in the debenture. An argument on those lines was addressed to the learned judge, at the conclusion of which he held that the simple contract debts were merged, and forgetting for the moment the limited extent to which he had declared the debenture invalid, he referred to the whole debenture as invalid, and held that the simple contract debts having been merged, and the debenture being invalid, the creditors were not entitled to retain the money paid to them through their trustee on 27 July.
>
> At the first hearing the learned judge had not declared, nor could he declare, the debenture invalid; all he could declare invalid was the charge therein contained. The rest of the document, the covenants to pay principal and interest, survived and was valid, for nothing in s 212 [IA 1986 s 245] affects them. The position therefore was that the simple contract creditors, by their trustee, who was the covenantee, were entitled to the benefit of the covenants to pay principal and interest, and on 27 July, when the company was in sufficient funds to pay the principal and interest, they had no alternative but to pay the same, and the trustee cannot on this summons be ordered to repay. But having regard to what has been disclosed in these proceedings, that the company was hopelessly insolvent from the beginning of March down to the date of the winding-up order, and that the effect of the payments to these half-dozen creditors on 27 July was to apply the whole available assets of the company to the payment of their debts in full and to leave other creditors whose debts largely exceeded the aggregate amount paid to the half-dozen unprovided for, raises a doubt whether the whole transaction, which culminated in the payments on 27 July, was not in the nature of a fraudulent preference. We desire therefore to give the liquidator an opportunity of considering the position from this standpoint, and in allowing this appeal to state that the order is without prejudice to any application to set aside the payments or to question the validity of the debenture on the ground of its being a fraudulent preference or on any other grounds which the liquidator may think fit to advance …
>
> MAUGHAM J concurred.

➢ Note

Re Parkes Garage was followed in *Mace Builders (Glasgow) Ltd v Lunn* [1987] Ch 191, [1987] BCLC 55, where the debenture holder had put in a receiver to enforce the charge and the receiver had sold the charged assets before the commencement of the winding up. Although the charge had been created within 12 months of the liquidation, and at a time when the company was insolvent, it was held that the provision corresponding to IA 1986 s 245 (Companies Act 1948 (CA 1948) s 322) was inapplicable: transactions completed before the liquidation were not affected by the section.

The phrase 'money[24] paid to the company' in IA 1986 s 245 includes cheques met by a bank on the company's behalf.

[12.17] Re Yeovil Glove Co Ltd [1965] Ch 148 (Court of Appeal)

The company had gone into liquidation having unsecured debts totalling £94,000 and an overdraft with the National Provincial Bank Ltd amounting to £67,000. This overdraft was secured by a floating charge given less than 12 months previously. During the currency of **(p. 621)** the charge the bank had met cheques drawn by the company amounting to £110,000, and received some £111,000 for payment into the company's account. (There were in fact four accounts, but this is not important.) The unsecured creditors attacked the security under CA 1948 s 322 (broadly comparable with IA 1986 s 245), alleging that no 'cash' had been 'paid to the company' by the bank within the meaning of that section; but the court treated the bank's acts in meeting the company's cheques as equivalent. It followed that, by virtue of the rule in *Clayton*'s case,[25] the bank could claim that the whole of the £67,000 was cash advanced subsequently to the creation of the charge, so that the security was valid for this sum.

> HARMAN LJ: [The] only question which arises is whether there was cash paid to the company at the time of or subsequently to the creation of, and in consideration for, the charge. It was admittedly created within twelve months of the winding up at a time when the company was insolvent. It is further agreed that so far as the overdraft was incurred before the date of the floating charge, the charge would not be a valid security for it. The liquidator's claim is a simple one, namely, that as neither cash nor a covenant to pay cash was made at the time of the execution of the document, there was no consideration for it in the legal sense of that term except the bank's immediate forbearance. This seemed to me, I confess, an attractive argument …
>
> It was argued that consideration in law is a well-known term and ought to receive its ordinary meaning, and that subsequent payments provided by the bank to defray the company's day-to-day outgoings or wages or salaries or indebtedness to its suppliers by cheque would not be consideration in law for the execution of a charge bearing an earlier date unless those payments were made in pursuance of a promise contained in, or made at or before the date of, the charge itself. It was, however, pointed out that such subsequent payments would in fact not be made in consideration for the charge, but in consideration for the promise.
>
> Now it is apparent on the fact of the section that cash subsequently paid to the company may be within the exception if so paid in consideration for the anterior charge, and the argument is that the words 'in consideration for' in this section cannot, therefore, be used in the technical sense, but mean 'by reason of' or 'having regard to the existence of' the charge. Oddly enough, there is no reported decision on these words, nor are they discussed in any of the well-known textbooks. There has, however, come to light a decision of Lord Romer, when a judge of first instance, in *Re Thomas Mortimer Ltd*,[26] in 1925, a decision on the corresponding section of the Companies (Consolidation) Act 1908, which was in the same terms as the present section except that the period was three instead of twelve months. A transcript of this judgment was before us. The facts of that case were, I think, indistinguishable from those of the present, and Romer J

held that payments by the bank after the date of the charge were made in consideration for the charge …

That decision, if right, is enough to cover the present question, and Plowman J [at first instance] so held …

In the instant case some £111,000, representing its trading receipts, was paid into the no 1 account by the company between the date of the charge and the appointment of the receiver, and the bank paid out during the same period about £110,000. Those payments were either made directly to or to the order of the company, or were transfers to the no 3 and no 4 accounts against advances previously made to the company to defray wages or salaries. All the company's accounts were at all times overdrawn, so that every payment was a provision of new money by means of which, on the figures, it is overwhelmingly probable that all the creditors existing at the date of the charge were in fact paid off.

There arises at this point the consideration which has given me most trouble in this case, namely, that as the no 1 account was carried on after as well as before the charge in precisely the same way, the bank would be entitled in accordance with the rule in *Clayton's* case, to treat payments in **(p. 622)** as being in satisfaction of the earliest advances made. The result is startling, for thus the bank pays itself out of moneys received subsequent to the charge for the whole of the company's indebtedness to it prior to the charge, and which was admittedly not covered by it. The result is that the whole of the pre-charge indebtedness is treated as paid off, and the bank is left bound to set off against its post-charge advances only the excess received after satisfying the company's pre-charge indebtedness. This would seem largely to nullify the effect of the section in the case of a company having at the date of the charge a largely overdrawn account with its bank, and which continues to trade subsequently. Of course, if at the date of the charge a line were drawn in the bank's books and a new account opened, then the company could successfully argue that payments out by the bank subsequent to the charge were, within a few hundred pounds, wholly repaid by the company from its trading receipts, with the result that no substantial sum would be due on the charge. It was, however, held by Romer J in *Re Thomas Mortimer Ltd* that *Clayton's* case be applied with the result stated, and I can see no escape from it, nor in spite of frequent pressing by the court did the appellant's counsel put forward any alternative … [It] follows, if the decision in *Re Thomas Mortimer Ltd* be right, that there is admittedly nothing left for the unsecured creditors. In my judgment Romer J's decision was right, and was rightly followed by Plowman J in the present case.

fallacy in the appellant's argument lies, in my opinion, in the theory that, because the company's payments into the bank after the date of the charge were more or less equal to the payments out by the bank during the same period, no 'new money' was provided by the bank. This is not the fact. Every such payment was in fact new money having regard to the state of the company's accounts, and it was in fact used to pay the company's creditors. That the indebtedness remained approximately at the same level was due to the fact that this was the limit set by the bank to the company's overdraft. I can find no reason to compel the bank to treat all payments in after the charge as devoted to post-charge indebtedness. The law is in fact the other way …

WILLMER and RUSSELL LJJ delivered concurring judgments.

➢ Note

The exception to IA 1986 s 245 discussed in the *Yeovil Glove* case applies only where the money in question is paid, or the goods or services supplied, to the company 'at the same time as, or after, the creation of the charge' (s 245(2)). There has recently been some debate in the cases about the meaning of this phrase: how nearly contemporaneous must the payment and the execution of the charge document be? In the past, this question was treated rather loosely, a delay of even two months or so being thought unimportant if the payment was made in anticipation of and in reliance on the creation of the charge. But in *Power v Sharp Investments Ltd* [1994] 1 BCLC 111, CA (also known as *Re Shoe Lace Ltd*), the Court of Appeal, agreeing with Hoffmann J in the court below, held that, while the question was one of fact and degree, a delay of any substantial length—although not, perhaps, the time taken to have a coffee-break—would be fatal to the application of the exception.

➢ Questions

1. What do you think are the policy reasons behind the enactment of IA 1986 s 245?

2. What do you think are the policy reasons behind the enactment of IA 1986 s 40 (see 'Distribution of assets subject to the receivership', pp 787ff)?

Distinguishing between fixed and floating charges

The previous sections indicate the need to distinguish between fixed and floating charges, and the substantial attractions to the charge holder in having a charge classified as fixed rather than floating. Lenders therefore devote considerable energy to drafting charges that **(p. 623)** will be construed as fixed rather than floating. Before considering the case extracts, several general points can be made.

(i) Prior to 1986, it was possible for the holder of a floating charge to evade the disadvantageous statutory rules simply by showing that the charge had crystallised (and thereby become a *fixed* charge) before the commencement of the liquidation or other relevant statutory date.[27] This loophole was quickly eliminated by IA 1986 s 251, which provides that 'floating charge' means 'a charge which, *as created*, was a floating charge'. Despite this setback, lenders have not been discouraged from seeking to achieve the same end result with ever more astutely worded documents.
(ii) In *Agnew v Commissioner of Inland Revenue (Re Brumark)* **[12.19]** (one of the leading cases in this area), the Privy Council held that, in analysing a charge agreement to determine whether it creates a fixed or a floating charge, the court's task is not to discover whether the parties *intended* to create a fixed or floating charge and then give effect to their intention. The court's task is to discover what *rights* the parties intended to create, and then to decide whether, as a matter of law, those rights constitute a fixed or a floating charge. See Lord Millett at **[12.19]**.
(iii) In the Irish case *Re Armagh Shoes Ltd* [1984] BCLC 405, Hutton J held that the fact that a document by its express words purports to create a fixed or specific charge does not prevent the court from construing the charge as a floating one. The judge in that case was also prepared to infer from the terms of the charge as a whole that the company had a licence to deal with the assets charged in the ordinary course of its business, even though this was not stated. More unusually, the courts have also held that a charge described as floating could, as a matter or law, be fixed: *Russell Cooke Trust Co Ltd v Elliott* [2007] EWHC 1443 (Ch), [2007] 2 BCLC 637.
(iv) In *Re Brightlife Ltd* **[12.12]**, in considering the scope of the freedom to deal with the charged assets, Hoffmann J held that a charge over book debts which was expressed to be a fixed charge, and imposed some restrictions on the use of the charged assets, was in reality a floating charge. He said, at 209:

> Although clause 3(A)(ii)(a) speaks of a 'first specific charge' over the book debts and other debts, the rights over the debts created by the debenture were in my judgment such as to be categorised in law as a floating charge …
>
> It is true that clause 5(ii) does not allow Brightlife to sell, factor or discount debts without the written consent of Norandex [the debenture-holder]. But a floating charge is consistent with some restriction upon the company's freedom to deal with its assets. For example, floating charges commonly contain a prohibition upon the creation of other charges ranking prior to or pari passu with the floating charge. Such dealings would otherwise be open to a company in the ordinary course of its business. In this debenture, the significant feature is that Brightlife was free to collect its debts and pay the proceeds

into its bank account. Once in the account, they would be outside the charge over debts and at the free disposal of the company. In my judgment a right to deal in this way with the charged assets for its own account is a badge of a floating charge and is inconsistent with a fixed charge.

(v) Despite this, freedom to deal with the charged assets is clearly a relative rather than an absolute concept, and some degree of freedom is not incompatible with a charge being a fixed charge. In *Re Cimex Tissues Ltd* [1994] BCLC 626, a charge over plant and machinery was held to be a fixed charge even though it was contemplated that some of the items of plant might be replaced from time to time as they wore out.
(p. 624) **(vi)** Nevertheless, it is precisely this issue of control over the use of the charged assets which plagues analysis (along with the related issue of control over their proceeds, as, eg with a charge over book debts, where it is relevant to look at the related control over their proceeds). Suppose the charge holder is a bank with a charge over a company's book debts: if use of the proceeds of the book debts is not controlled at all, then the charge is floating (*Re Brightlife Ltd* **[12.12]**, although in this case the chargee was not itself a bank); and if use of the proceeds is completely restricted, then the charge is fixed (*Re Keenan Bros Ltd* [1986] BCLC 242, where the chargee bank stipulated that the account could not be drawn against without the counter-signature of one of its officers). But if neither the freedom nor the control is absolute, then a judgement is required. In *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, for example, the company was forbidden to deal with the book debts *before collection* in certain specified ways but not in every conceivable way; there was also a right to obtain absolute control by giving notice, but this right was never exercised. The charge was held by Slade J to be a fixed charge, but his decision was overruled 25 years later by the House of Lords in *Spectrum***[12.20]**.
(vii) Clearly there are limits to what can be achieved by drafting alone. In *Royal Trust Bank v National Westminster Bank plc* [1996] 2 BCLC 699, CA, an instrument creating a charge over book debts gave the chargee bank the *right* to demand that the company should open a dedicated account and pay all moneys received on the collection of the debts into that account, but the bank never exercised this right, and in practice moneys collected went into the company's ordinary trading account. The charge was held by Millett LJ to be floating. (All three members of the court concurred in the result; Nourse LJ on other grounds, and Swinford Thomas LJ without giving reasons.)
(viii) Similarly, in *Re Double S Printers Ltd* [1999] 1 BCLC 220 the chargee, as a director of the company, had *de facto* control over the proceeds of the charged book debts since he had actual control of the bank account, but this was not backed by any contractual restraint on their disposal in the instrument itself. As in the *Royal Trust Bank* case, it was held that the company's freedom (at least in law) to deal led to the conclusion that the charge was floating.
(ix) More imaginative structures have been adopted. Perhaps the most notorious is that which was successfully proposed in *Re New Bullas Trading Ltd* **[12.18]**(although subsequently held to be wrong by the Privy Council in *Brumark* **[12.19]**, and now overruled by the House of Lords in *Spectrum* **[12.20]**). In *New Bullas*, the company granted a charge over book debts which was expressed to be a fixed charge over the uncollected book debts and a floating charge over their proceeds. The Court of Appeal, overruling Knox J, held that this was possible. The decision caused a good deal of controversy. It was followed in Australia (*Whitton v CAN 003 266 886 Pty Ltd* (1997) 42 NSWLR 123) but disowned by the New Zealand Court of Appeal (*Re Brumark Investments Ltd, Commissioner of Inland Revenue v Agnew* [2000] 1 BCLC 353, [2000] 1 NZLR 223). The Privy Council subsequently upheld the *Brumark* ruling, and held that *New Bullas* was wrongly decided: see **[12.19]**.
(x) It is apparent from all of this that, of the three attributes of the floating charge identified by Romer LJ in *Re Yorkshire Woolcombers Ltd* (cited in **[12.04]**), it is the third—the trading power—which is normally regarded as crucial. The other two features, while characteristic of most floating charges, are less essential: in *Bond Worth* **[12.07]** two of the classes of assets affected were not 'present and future' but exclusively present (the goods) and exclusively future (the proceeds) respectively. And in *Welch v Bowmaker (Ireland) Ltd* [1980] IR 251 the second of the criteria—the expectation that the class of assets would be turned over in the course of business—was lacking: a charge over a parcel of land presently owned by the company was ruled to be a floating charge.
(p. 625) **(xi)** This makes it rather extraordinary that in *Re Atlantic Computer Systems plc* [1992] Ch 505, CA (followed on similar facts in *Re Atlantic Medical Ltd*[1993] BCLC 386), the Court of Appeal appears to have been influenced almost entirely by the fact that the property affected by the charge was specific (rental

moneys payable to the company under existing, identified computer-leasing agreements) in holding that the charge was a fixed charge. The fact that this property was not ‘ambulatory and shifting in nature’ seems to have been regarded as conclusive in itself, even though the rental moneys when received by the company were used by it in the ordinary course of business and the instrument did not prohibit this. Since this is a ruling of the Court of Appeal, it must be accorded due weight; but after the decisions of the Privy Council in *Brumark* **[12.19]** and the House of Lords in *Spectrum* **[12.20]** (neither of which referred to these cases), their authority must now be regarded as questionable.

A fixed charge may be created over book debts, including future book debts, but will be treated as a floating charge if the chargor is free to realise or collect the debts for his own account.

[12.18] Re New Bullas Trading Ltd [1994] 1 BCLC 485 (Court of Appeal)

This case, now overruled, is not extracted here, but given its notoriety and the continued reference to it in subsequent cases, it seems sensible to give it some attention. The case was decided on the basis of the contractual freedom of the parties to do what they proposed, in the absence of contrary arguments based on public policy. Reaction to the Court of Appeal decision was probably the impetus for the subsequent radical overhaul and a more tightly reasoned judicial approach to this area.

The company had executed a security document in favour of 3i plc which purported to create a fixed charge over book debts, so long as they remained uncollected, but when the proceeds of the debts had been collected and paid into a designated bank account (unless written instructions to the contrary were given by 3i) the moneys so received were released from the fixed charge and became subject to a floating charge. At first instance, Knox J held that the charge was a floating charge throughout and that in consequence the company’s preferential creditors were entitled in a receivership to priority under IA 1986 s 40 as regards the uncollected debts. The Court of Appeal reversed this decision, holding that there were commercial advantages for both parties in these arrangements (having a fixed charge over the uncollected debts and a floating charge over the proceeds when collected); that the parties were free to agree to such terms; and that the wording of the debenture did have the effect of making the security over the uncollected book debts a fixed charge.

➢ Note

The ruling in this case was strongly criticised by Professor Goode (‘Charges over Book Debts: A Missed Opportunity’ (1994) 110 LQR 592). In his view, it is not possible to create separate security interests over a debt and its proceeds: all that it is possible to have is a single, continuous security interest which moves from debts to proceeds. If the chargee does not retain sufficient control over the proceeds when collected, the charge, ‘*as created*’, must be regarded as a floating charge. This is because ‘the distinctive feature of debts as an object of security is that they are realised by payment, upon which they cease to exist’.

Goode’s view later received support from Millett LJ in *Royal Trust Bank v National Westminster Bank plc* [1996] 2 BCLC 682, where he said (at 704): ‘while it is obviously possible to distinguish between a capital asset and its income, I do not see how it can be possible to separate a debt or other receivable from the proceeds of its realisation’.

New Bullas drew comment from other academic commentators. Griffin (1995) 46 *Northern Ireland Law Quarterly* 163, in reply to Professor Goode, condemned the notion that a charge **(p. 626)** over book debts and their proceeds must always be of an indivisible nature as ‘misconceived’. A similar view was taken by McLauchlan in (2000) 116 LQR 211. Worthington, in contrast (1997) 113 LQR 563, while not supporting the view that a book debt and its proceeds constitute an indivisible asset, considered that the wrong conclusion had been reached in *New Bullas* because the security arrangement had left the chargor free to remove the charged assets from the ambit of the security without recourse to the chargee.

In the event, it is this last view which has been upheld. The Privy Council, in an appeal from New Zealand in the case next cited, stated categorically that *New Bullas*was wrongly decided and so it must be taken as having been to all intents and purposes overruled.

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

[See the shorter extract at **[12.04]**.]

Brumark had given security over its book debts to its bank (Westpac) in terms which were indistinguishable from those in *New Bullas* **[12.18]**—that is, which purported to make the debts subject to a fixed charge so long as they were uncollected but a floating charge over the proceeds once they had been collected and received by the company. The company was free to collect the debts for its own account and to use the proceeds in its business. Brumark went into receivership and the receivers collected the outstanding debts. Fisher J at first instance held that, as uncollected debts, they were subject to a fixed charge (as the parties had agreed) and, as such, not subject to the claims of the company's preferential creditors. The New Zealand Court of Appeal, declining to follow *New Bullas*, held that the fact that the company was free to collect the debts for its own account (and so remove them from the bank's security) was inconsistent with the charge being a fixed charge. It was accordingly a floating charge and the preferential creditors had a prior claim to the proceeds. This ruling was affirmed by the Privy Council.

> The opinion of the Judicial Committee was delivered by LORD MILLETT:… The question in this appeal is whether a charge over uncollected book debts of a company which leaves the company free to collect them and use the proceeds in the ordinary course of its business is a fixed charge or a floating charge.
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> [His Lordship set out the facts and the terms of the debenture and continued:] The question is whether the company's right to collect the debts and deal with their proceeds free from the security means that the charge on the uncollected debts, though described in the debenture as fixed, was nevertheless a floating charge until it crystallised by the appointment of the receivers. This is a question of characterisation. To answer it their Lordships must examine the nature of a floating charge and ascertain the features which distinguish it from a floating charge … [His Lordship traced the history of the floating charge, referring to cases from *Re Panama, New Zealand and Australian Royal Mail Co*[28] to *Re Cosslett (Contractors) Ltd* **[12.08]**, emphasising in particular the following passage from the judgment of Vaughan Williams LJ in *Re Yorkshire Woolcombers Association Ltd* (cited in *Re Cosslett (Contractors) Ltd* **[12.08]**):
>
> > '… but what you do require to make a specific security is that the security whenever it has once come into existence, and been identified and appropriated as a security, shall never thereafter at the will of the mortgagor cease to be a security. *If at the will of the mortgagor he can dispose of it and prevent its being any longer a security, although something else may be substituted more or less for it, that is not a "specific security"* (emphasis added).]
>
> [His Lordship referred to the wording of the debentures in this case and in *New Bullas* and continued:] The intended effect of the debenture was the same in each case. Until the charge holder **(p. 627)** intervened the company could continue to collect the debts, though not to assign or factor them, and the debts once collected would cease to exist. The proceeds which took their place would be a different asset which had never been subject to the fixed charge and would from the outset be subject to the floating charge.
>
> The question in *New Bullas*, as in the present case, was whether the book debts which were uncollected when the receivers were appointed were subject to a fixed charge or a floating charge. …
>
> The principal theme of the judgment [in *New Bullas*]… was that the parties were free to make whatever agreement they liked. The question was therefore simply one of construction; unless unlawful the intention of the parties, to be gathered from the terms of the debenture, must prevail. It was clear from the descriptions which the parties attached to the charges that they had intended to create a fixed charge over the book debts while they were uncollected and a floating charge over the proceeds. It was open to the

parties to do so, and freedom of contract prevailed.

Their Lordships consider this approach to be fundamentally mistaken. The question is not merely one of construction. In deciding whether a charge is a fixed charge or a floating charge, the court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it. … In construing a debenture to see whether it creates a fixed or a floating charge, the only intention which is relevant is the intention that the company should be free to deal with the charged assets and withdraw them from the security without the consent of the holder of the charge; or, to put the question another way, whether the charged assets were intended to be under the control of the company or of the charge holder.

[His Lordship considered and rejected an argument which had been upheld by the Court of Appeal in *New Bullas*: that the book debts did not cease to be subject to the charge at the will of the company but that they ceased to be subject to the charge because that was what the parties had agreed in advance when they entered into the debenture. He also rejected as irrelevant a distinction which Fisher J had drawn between a power on the part of the company to *dispose of* the debts (eg by factoring them) and a power to *consume* them (by realising them). He continued:] Their Lordships turn finally to the questions which have exercised academic commentators: whether a debt or other receivable can be separated from its proceeds; whether they represent a single security interest or two; and whether a charge on book debts necessarily takes effect as a single indivisible charge on the debts and their proceeds irrespective of the way in which it may be drafted.

Property and its proceeds are clearly different assets. On a sale of goods the seller exchanges one asset for another. Both assets continue to exist, the goods in the hands of the buyer and proceeds of sale in the hands of the seller. If a book debt is assigned, the debt is transferred to the assignee in exchange for money paid to the assignor. The seller’s former property right in the subject matter of the sale gives him an equivalent property right in its exchange product. The only difference between realising a debt by assignment and collection is that, on collection, the debt is wholly extinguished. As in the case of alienation, it is replaced in the hands of the creditor by a different asset, viz its proceeds.

The Court of Appeal saw no reason to examine the conceptual problems further. They held that, even if a debt and its proceeds are two different assets, the company was free to realise the uncollected debts, and accordingly the charge on those assets (being the assets whose destination was in dispute) could not be a fixed charge. There was simply no need to look at the proceeds at all. …

If the company is free to collect the debts, the nature of the charge on the uncollected debts cannot differ according to whether the proceeds are subject to a floating charge or are not subject **(p. 628)** to any charge. In each case the commercial effect is the same: the charge holder cannot prevent the company from collecting the debts and having the free use of the proceeds. But it does not follow that the nature of the charge on the uncollected book debts may not differ according to whether the proceeds are subject to a fixed charge or a floating charge; for in the one case the charge holder can prevent the company from having the use of the proceeds and in the other it cannot. The question is not whether the company is free to collect the uncollected debts, but whether it is free to do so for its own benefit. …

To constitute a charge on book debts a fixed charge, it is sufficient to prohibit the company from realising the debts itself, whether by assignment or collection. But … it is not inconsistent with the fixed nature of a charge on book debts for the holder of the charge to appoint the company its agent to collect the debts for its account and on its behalf. *Siebe Gorman*[29] and *Re Keenan* [‘Distinguishing between fixed and floating charges, point (vi), p 624] merely introduced an alternative mechanism for appropriating the proceeds to the security. The proceeds of the debts collected by the company were no longer to be trust moneys but they were required to be paid into a blocked account with the charge holder. The commercial effect was the same: the proceeds were not at the company's disposal. Such an arrangement is inconsistent with the charge being a floating charge, since the debts are not available to the company as a source of its cash flow. But their Lordships would wish to make it clear that it is not enough to provide in the debenture that the account is a blocked account if it is not operated as one in fact. …

Their Lordships consider that *New Bullas* was wrongly decided.

[12.20] Re Spectrum Plus Ltd [2005] UKHL 41, [2005] 2 AC 680 (House of Lords)

The company granted a charge over its book debts to the bank, expressed to be 'by way of specific charge', prohibiting disposal of the book debts and requiring the proceeds to be paid into an account with the chargee bank. The bank permitted the company to draw on these proceeds for use in the ordinary course of business, subject to certain restrictions. In its terms, the charge was in the same form as that which had been accepted by Slade J as a fixed charge in *Siebe Gorman*.[30] If it was a floating charge, the preferential creditors would be entitled to have their debts paid out of the proceeds of the book debts in priority to the bank (IA 1986 s 175); if not, the bank would be entitled to the whole of the proceeds. The amount at stake was relatively trivial (approximately £16,000). But the case was run as a test case, with several hundred liquidations held up pending the resolution of the issue. The debenture was in a form used by many banks and other commercial lenders. Indeed, the company had gone into liquidation and took no part in the proceedings; the case was argued between the bank (as the secured creditor) and the Crown (as preferential creditor in the liquidation (see 'Distribution of assets subject to the receivership', pp 787ff)).

LORD HOPE:… [I]t is competent for anyone to whom book debts may accrue in the future to create for good consideration an equitable charge upon those book debts which will attach to them as soon as they come into existence. But if this is to be effective as a fixed security everything depends on the way the security agreement ensures that the charge over the book debts is fixed. It is not easy to reconcile the company's need to continue to collect and use these sums for its own business purposes with the lender's wish to escape from the priority which section 175(2)(b) of the 1986 Act gives to preferential debts …

There are, as Professor Sarah Worthington has pointed out, a limited number of ways to ensure that a charge over book debts is fixed: *An 'Unsatisfactory Area of the Law'—Fixed and Floating Charges Yet Again* (2004) 1 International Corporate Rescue 175, 182. One is to prevent all dealings **(p. 629)** with the book debts so that they are preserved for the benefit of the chargee's security. … One can, of course, be confident where this method is used that the book debts will be permanently appropriated to the security which is given to the chargee. But a company that wishes to continue to trade will usually find the commercial consequences of such an arrangement unacceptable. Another is to prevent all dealings with the book debts other than their collection, and to require the proceeds when collected to be paid to the chargee in reduction of the chargor's outstanding debt. But this method too is likely to be unacceptable to a company which wishes to carry on its business as normally as possible by maintaining its cash flow and its working capital. A third is to prevent all dealings with the debts other than their collection, and to require the collected proceeds to be paid into an account with the chargee bank. That account must then be blocked so as to preserve the proceeds for the benefit of the chargee's security. A fourth is to prevent all dealings with the debts other than their collection and to require the collected proceeds to be paid into a separate account with a third party bank. The chargee then takes a fixed charge over that account so as to preserve the sums paid into it for the benefit of its security.

The method that was selected in this case comes closest to the third of these. It was selected, no doubt, because it enabled the company to continue to trade as normally as possible while restricting it, at the same time, to some degree as to what it could do with the book debts. The critical question is whether the restrictions that it imposed went far enough. There is no doubt that their effect was to prevent the company from entering into transactions with any third party in relation to the book debts prior to their collection. The uncollected book debts were to be held exclusively for the benefit of the bank. But everything then