The Spectrum Plus Case: Fixed or Floating Charges over Book Debts in England

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I. INTRODUCTION

As the world becomes increasingly globalized, United States bankers need to be aware of the different laws regarding secured transactions in other countries. The differences in laws are important, as they may have a fundamental impact on a lender's rights when a borrower becomes insolvent. Understanding the laws of England is especially important as "there are currently more U.S.-owned banks operating branches and subsidiaries in London than there are on Wall Street." As of 1997, there were at least thirty-seven U.S. banks with branches in London. Smaller banks are also tied to the United Kingdom, as many have correspondent relationships with major British banks. These correspondent relationships allow banks to provide a variety of financial services for exporters and importers.

While England is a part of the United Kingdom, its legal system is separate from that of Wales, Scotland, and Northern Ireland. The

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2. See Letter from Cadwalader, Wickersham & Taft L.L.P., Spectrum Follows Brumark on Charges over Book Debts (Feb. 4, 2004), at http://www.cadwalader.com/assets/client_friend/SpectrumBookDebts02-04-04.pdf (discussing different types of security may have a fundamental impact on the lender's legal rights to his or her collateral).


5. MOORE, supra note 3.

6. Id.

House of Lords, however, is the high court for all of these countries. While the House of Lords' decisions are binding on lower courts in the United Kingdom, its rulings are only persuasive in other English law jurisdictions. As there are many English law jurisdictions around the world, decisions issued by the House of Lords garner a great deal of attention in the international realm.

This Note considers the English security system, specifically the concept of fixed and floating charges over book debts. Part II will look at the entire English system of secured lending to consider how charges relate to other types of security interests. It will provide a brief overview of pledges, mortgages, charges, and lines. Part III will then look closer at fixed and floating charges. Specifically, Part III examines the benefits and drawbacks of fixed and floating charges over book debts. Part IV provides an overview of the evolution of fixed charges over book debts. Part A outlines the early cases that established this concept. Part B looks in detail at the Spectrum Plus.

8. Id.
11. See, e.g., Fixed or Floating?, THE ECONOMIST, July 31, 2004, at 64.
12. Simply put, book debts are money owed to someone (e.g. a corporation) by an individual. Fixed/Floating Charges on Book Debts, GLOBAL LAW REVIEW, INDIA LAW & INT’L RES. (Dec. 5, 2003), at http://www.globallawreview.com/charges.html. A more technical explanation is as follows: Book debts are not defined by the Companies Act, but the accepted definition is a book debt belonging to a company that arose in the ordinary course of that company’s business, and would, under typical practices, be entered into the company’s books. P.A.U. ALL, THE LAW OF SECURED FINANCE: AN INTERNATIONAL SURVEY OF SECURITY INTERESTS OVER PERSONAL PROPERTY 137 (2002). It is important to note that the debt does not actually have to be entered into the company’s books to be considered a book debt under the company’s accounting principles, rather it only has to be a debt that would typically be entered into a company’s books. Id. The following are examples of what constitutes a book debt: “bills of exchange, cheques, promissory notes, debts due under hire purchase agreements and conditional sales, and leases of land.” Id. at 137-38. In comparison, the following are not book debts: “credit balances of bank accounts... a charge/mortgage over such balances... debts subject to a contingency... charges over the benefit of insurance policies and guarantees.” Id. at 138.
13. See infra Part II.
14. Id.
15. See infra Part III.
16. Id.
17. See infra Part IV.
18. See infra Part IV.A.
case and the differing opinions of the Chancery Court and Court of Appeals.\textsuperscript{19} Part C provides a brief overview of the legal status of fixed charges over book debts following the Court of Appeals ruling.\textsuperscript{20} Part V analyzes the current laws and considers the Law Commission's possible changes to those laws.\textsuperscript{21}

II. BACKGROUND ON SECURED LENDING IN ENGLAND

England's laws relating to secured lending are somewhat different from the United States' laws.\textsuperscript{22} Currently, in England, there are four different types of security interests: pledges, mortgages, charges, and liens.\textsuperscript{23}

A pledge is essentially the U.S. version of a possession security interest.\textsuperscript{24} It is the "delivery of possession by way of security," which makes a pledge a strong security interest.\textsuperscript{25} The creditor or lender takes possession of the asset that is security.\textsuperscript{26} Having possession of the security places the lender in a good position to enforce her security because she can sell the asset at any time after the borrower defaults.\textsuperscript{27} One limitation of a pledge is that it only applies to tangible assets, meaning it cannot be used when securities or book debts are used as collateral.\textsuperscript{28} A pledge is a legal security interest rather than an equitable interest, which is an important distinction as legal interests have priority over equitable interests in an insolvency.\textsuperscript{29}

A mortgage is similar to the U.S. mortgage.\textsuperscript{30} In the U.K. it is

\textsuperscript{19} See infra Part IV.B.
\textsuperscript{20} See infra Part IV.C.
\textsuperscript{21} See infra Part V.
\textsuperscript{22} See GERARD MCCORMACK, SECURED CREDIT UNDER ENGLISH AND AMERICAN LAW 1 (2004), (contrasting approaches to security interests in England with those in the United States).
\textsuperscript{23} DR. JOANNA BENJAMIN, INTERESTS IN SECURITIES: A PROPRIETARY LAW ANALYSIS OF THE INTERNATIONAL SECURITIES MARKETS 97 (2000). These interests are listed in order of priority. Id.
\textsuperscript{24} See BLACK'S LAW DICTIONARY 943 (8th ed. 2004) (defining a possessory lien as one where the creditor retains the good until the debt is satisfied).
\textsuperscript{25} BENJAMIN, supra note 23, at 98.
\textsuperscript{26} Id.
\textsuperscript{27} Id.
\textsuperscript{28} Id.
\textsuperscript{29} Id. at 98.
\textsuperscript{30} BLACK'S LAW DICTIONARY, supra note 24, at 1026 (defining a mortgage as the conveyance of title to property that provides security for a debt or as a lien against property
defined as the “delivery of title by way of security,” which means that the borrower (the mortgagor) gives the title of the mortgaged asset to the lender (the mortgagee), “subject to the equity of redemption, which the mortgagor retains.” A security interest in the form of a mortgage can be either legal or equitable. If it is a legal interest, then the borrower delivers the full and equitable title to the lender, whereas if it is an equitable security interest, the borrower/mortgagor only delivers the equitable title to the lender. As legal security interests have priority over equitable ones, a legal mortgage has priority over an equitable mortgage.

A charge is less substantial than a pledge or a mortgage, and being an equitable charge, it ranks behind both in priority. It gives the lender the right to appropriate the charged asset in order to satisfy the borrower’s indebtedness. A charge can be created with no formality; all that is required is an agreement to create the charge. The lack of formality in creating a charge makes charges useful when the collateral is not an intangible, like a book debt. There are two types of charges—the fixed charge and the floating charge.

A lien is also similar to the U.S. concept of a lien. It is defined in the U.K. as a “security interest based on possession,” which allows the lender to retain possession of the assets until the secured obligation is paid off. A lien can create either a legal (contractual) or equitable interest in the collateral. A lien is different from a pledge in that the lienee is entitled to possession of the property but is not allowed to

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31. BENJAMIN, supra note 23, at 99.
32. Id.
33. Id.
34. Id. at 100.
35. Id. at 101.
36. BENJAMIN, supra note 23, at 101.
37. Id.
38. Id.
39. Id; see infra notes 50-55 and accompanying text.
40. BLACK’S LAW DICTIONARY, supra note 24, at 933 (defining a lien as a legal right or interest that a creditor has in another person’s property until the debt is satisfied—possession is not typically taken).
41. BENJAMIN, supra note 23, at 104.
assign or sell the property, as that would extinguish the lien.\textsuperscript{43} In regard to a pledge, the secured party is allowed to sell the secured property, discharging the secured obligation with the proceeds from the sale.\textsuperscript{44} A lien does not include the power of sale.\textsuperscript{45} Therefore, it is of little use when the collateral is going to be used in the securities market.\textsuperscript{46}

III. FIXED CHARGE VERSUS FLOATING CHARGE

When determining if a charge is fixed or floating, it does not matter that the actual collateral may change from time to time.\textsuperscript{47} The crucial test for determining the category in which a charge falls is "whether or not the chargor is free to dispose of the charged assets without the consent of the chargee."\textsuperscript{48} However, it is "sufficient to merely restrict the freedom of the chargor to deal with the charged assets" when trying to avoid the creation of a floating charge.\textsuperscript{49}

A fixed charge is a charge that attaches to a particular identifiable asset, which means that the borrower may not dispose of the asset without permission from the lender.\textsuperscript{50} Fixed charges currently may be created over "a changing pool of assets."\textsuperscript{51} It is important to note that the terms "fixed charge" and "equitable mortgage" are sometimes used interchangeably.\textsuperscript{52}

A floating charge is a charge that does not initially attach to a particular asset which means the borrower is allowed to dispose of the assets as he or she wishes without having to get the consent of the lender.\textsuperscript{53} It relates to a "changing class of present and future assets" until it is crystallized (which typically occurs when the borrower defaults on the loan).\textsuperscript{54} Floating charges are considered beneficial for the borrower because they allow the borrower to grant the lender a

\begin{itemize}
\item \textsuperscript{43} \textit{Id.} at 91 (explaining that liens are not assignable).
\item \textsuperscript{44} \textit{Id.} at 99.
\item \textsuperscript{45} BENJAMIN, supra note 23, at 104.
\item \textsuperscript{46} \textit{Id.} at 105.
\item \textsuperscript{47} \textit{Id.} at 102.
\item \textsuperscript{48} \textit{Id.}
\item \textsuperscript{49} \textit{Id.}
\item \textsuperscript{50} BENJAMIN, supra note 23, at 103.
\item \textsuperscript{51} \textit{Id.} at 102.
\item \textsuperscript{52} \textit{Id.} at 101-02.
\item \textsuperscript{53} \textit{Id.}
\item \textsuperscript{54} \textit{Id.} at 102.
\end{itemize}
security interest, but at the same time, the borrower is able to use the asset in the normal course of business without interruption.\footnote{Benjamin, supra note 23, at 102.} Like the United Kingdom and other English-law jurisdictions, the United States recognizes the existence of a fixed charge or security over liquid collateral.\footnote{McGuire Woods, L.L.P., supra note 1, at 3.} No distinctions, however, are made between fixed and floating charges in the U.S. law.\footnote{McCormack, supra note 22, at 71.} If the parties entering into the security agreement used language similar to that typically used in a floating charge, that attachment would occur at the time the agreement is entered into rather than hovering over the asset as it would under English law.\footnote{Id. at 73.} This recognition of a "floating" security interest over collateral asserts the idea that a fixed security interest is not necessarily incompatible with the borrower having the freedom to use and dispose of the secured asset in the ordinary course of business.\footnote{Id. at 75; see U.C.C. 9-205(a)-(d) (2001).} However, under U.S. law, the contractual security agreement provides whether the borrower is allowed to dispose of the collateral "free of the security interest."\footnote{U.C.C. § 9-315(a)(1).} If the borrower is allowed to sell the goods, then the security interest in the goods is extinguished and the lender's interest continues in any proceeds resulting from the sale.\footnote{Id.}

The difference between a fixed and floating charge over book debts, and the legal ramifications of such a distinction, have a significant impact on the lender's rights to the charged collateral.\footnote{See Cadwalader, Wickersham & Taft L.L.P., supra note 2, at 1 (discussing the impact of the different legal effects of each type of charge in determining the rights of the secured lender).} Fixed charges are considered especially beneficial because they give the creditor priority over preferential creditors\footnote{Preferential creditors include, for example, employees, Inland Revenue, and Customs & Excise. Nat'l Westminster Bank Plc. v. Spectrum Plus Ltd., 2004 WL 61957, ¶ 5.} and holders of floating charges when the borrower defaults.\footnote{Charges over Book Debts, Banknotes 1 (Summer 2004) (on file with the North Carolina Banking Institute Journal).} In the eyes of a bank granting businesses loans, the most obvious negative feature of a floating charge is that floating charges are paid only after fixed charges and preferential
creditors have been paid.\textsuperscript{65} Floating charges, on the other hand, are more likely to be set aside than fixed charges during a liquidation as a result of § 245 Insolvency Act of 1986.\textsuperscript{66} That act allows for floating charges created within 12 months of the company becoming insolvent to be set aside.\textsuperscript{67} A fixed charge over book debts gives a bank a great deal of power over a company.\textsuperscript{68} As book debts are usually the primary asset of a company,\textsuperscript{69} having them for security increases the lender’s chances of recovering its money, which is one of the reasons for taking security.\textsuperscript{70} When a bank has this type of security, the bank has control over a very valuable asset that provides the working capital for the company.\textsuperscript{71} As the security is very important to the company, it gives an incentive to not default because the borrower’s failure to pay would result in the loss of a crucial asset.\textsuperscript{72} Also, when a company enters financial distress, the bank is able to wield a great deal of power and force the company to do a variety of things, including a restructuring of management or anything else the bank may think will save the company from insolvency.\textsuperscript{73} Holders of a fixed charge also have self-help remedies that are not available to those with a floating charge.\textsuperscript{74} Section 29 of the


\textsuperscript{67} Jonathan L. Black-Branch, Loan Capital, Debentures, Fixed and Floating Charges, CONSILIO, at \url{www.spr-consilio.com/loancapital.html}.

\textsuperscript{68} MCCORMACK, supra note 22, at 7.


\textsuperscript{70} MCCORMACK, supra note 22, at 5. Statistically speaking, on average, 75\% of cases will return nothing to unsecured creditors, and only 2\% of unsecured creditors can expect a 100\% return. \textit{Id.} at 7. Banks, with security, usually recover about 77\% of the money they loaned while preferential creditors usually get about 27\%, and there are negligible returns for unsecured creditors. \textit{Id.}

\textsuperscript{71} MCCORMACK, supra note 22, at 7.

\textsuperscript{72} \textit{Id.}

\textsuperscript{73} \textit{Id.} at 10.

\textsuperscript{74} Anthony Fanshawe & Kate Shimmin, Die Another Day: The Fixed Charge on Book Debts Lives on, RECOVERY, at 22 (Spring 2004), at \url{http://www.bllaw.co.uk/content/our_services/banking/news/n999_4.pdf}.
Insolvency Act of 1986, also allows the holder of a charge over substantially all of the borrower’s assets to appoint an administrative receiver to enforce the charge— a powerful tool since book debts are usually the prime asset of a company and qualify as a substantial amount of the borrower’s assets. If the holder of a fixed charge is able to appoint the administrative receiver, it gives the holder of the fixed charge three advantages:

(1) an administrative receiver answers to and is directed by the secured lender; (2) the appointment of such administrator prevents the appointment of an ordinary administrator who answers to the court; and (3) administrative receivers may, upon court approval, cause the sale of an asset even though it is sometimes encumbered by a prior lien if the administrator can show superior recovery may result.

The Enterprise Act of 2002 also allows chargees to take control over charged assets without judicial intervention, which provides the chargee with a substantial degree of control when recovering their assets from a company in financial distress.

In addition, the Enterprise Act of 2002 negatively impacted the floating charge by stipulating all floating charge created after September 15, 2003 are subject to the levy of the “prescribed part” fund. That means that about twenty percent of the net property remaining after fixed charges and preferential debts are paid, the assets which could be subject to a floating charge, goes into the fund for unsecured creditors. The money that goes into that fund will be for the benefit of unsecured lenders.

78. MCCORMACK, supra note 22, at 8-9.
79. Fanshawe & Shimmin, supra note 74, at 22.
81. Fanshawe & Shimmin, supra note 74, at 22.
While there are many benefits to retaining fixed charges, they do present some policy concerns. One particularly relevant concern is that banks no longer need to engage in detailed (and expensive) analysis of the financial circumstances of the borrower and the borrower's venture because they simply have to compare the value of the security to the loan to ensure the security covers the loan. Banks and other financial institutions have the knowledge and resources to determine whether or not to make a loan and should not have to rely on collateral when deciding whether or not to provide a loan. Banks tend to prefer secured loans because there is a moral hazard problem in unsecured lending. The issue is that the borrower is more likely to be irresponsible with the money loaned when the borrower is not threatened with the loss of an important asset, whereas a secured loan ties the money to an asset and the threat of losing the asset supposedly makes the lender more responsible. The use of collateral is attractive, especially in the form of a fixed charge, where the bank has priority, because screening is expensive. Due to reliance on collateral, banks may fail to screen at a socially-efficient level, which, in the end, can lead to investing in too many projects that will fail. It is important to note that banks have made a point that they are still concerned with assessing the viability of a borrower's business plan. The banks explain that "collateral is only taken as a contingency in case things don’t work out." The absence of a fixed charge over book debts may encourage banks to conduct more thorough investigations, which is beneficial as commercial lenders are better able to spread risk than some other groups. Collateral, and the guarantee of getting the majority of the loaned money back through the collateral, discourages (or provides little

82. MCCORMACK, supra note 22, at 9.
83. Fanshawe & Shimmin, supra note 74, at 22.
84. Id.
86. Id.
87. Id. at 22.
88. MCCORMACK, supra note 22, at 10.
89. Id.
90. MANOVE ET AL., supra note 85, at 22.
91. MCCORMACK, supra note 22, at 27.
incentive for) banks to investigate the borrower and the borrower’s business plan. Taking away that safety-net provided by collateral may encourage more investigations. With the floating charge, the possibility of having a floating charge set aside is also an incentive for the banks to conduct thorough investigations when lending to any borrower.

One of the main attractions of a floating charge over book debts is that the “chargor is allowed to continue using the charged property in the ordinary course of business as if the property was not charged, and can continue to do so until the secured creditor takes a step under the charge to stop it” (i.e. until the charge is crystallized – typically when a default occurs). Floating charges over book debts therefore provide a business oriented solution that both gives banks security and allows businesses to continue using the capital from book debts in everyday business. This benefit of a floating charge, however, does not minimize the problem for chargees that English insolvency legislation ranks preferential creditors and fixed charges ahead of floating charges, meaning a holder of a floating charge is less likely to recover her money.

IV. THE EVOLUTION OF FIXED CHARGES OVER BOOK DEBTS

A. The Early Cases

Fixed charges over book debts have been controversial since the courts first recognized their existence in 1979, in Siebe Gorman & Co. v. Barclays Bank. In that case, Siebe Gorman sued Barclays Bank and a company called R.H. McDonald (hereinafter “RHM”) in an attempt to recover the money RHM owed them. RHM had entered a debenture

92. MANOVE ET AL., supra note 85, at 22.
93. Id.
94. Id.
96. Id.
97. Id.
99. Id. at 143.
with Barclays which gave the bank a fixed charge over the company's book debts and other debts, and also ensured that RHM would be unable to "dispose of" the charged assets except by a sale in the ordinary course of business. RHM also agreed to give Siebe Gorman a deed of assignment over certain debts that the bank already had a charge over. RHM eventually became insolvent and owed Barclays and Siebe Gorman, among others, significant amounts of money. As a result, Siebe Gorman issued a writ against RHM and Barclays in an attempt to recover its money. At issue was whether or not the Barclay debenture created a fixed charge over book debts, and thereby giving Barclay priority over Siebe Gorman's assignment. The court held:

It is perfectly possible in law for a [chargor], by way of continuing security for future advances, to grant a [chargee] a charge on future book debts in a form which creates in equity a specific charge on the proceeds of such debts as soon as they are received and consequently prevents the [chargor] from disposing of an unencumbered title to the subject matter of such charge without the [chargee's] consent, even before the [chargee] has taken steps to enforce its security. It was established that the chargee needed to have sufficient control over the disposal, collection, and use of the proceeds, in order to create a fixed charge over book debts, but the court failed to elaborate on what would qualify as "sufficient." Eight years after Siebe Gorman, the issue of fixed charges was in front of the High Court in Re Brightlife Ltd. That case dealt with

100. Id. at 142.
101. Id. at 150. The parties at least intended it to be a charge, but the court later held that the assignment was not a charge, and therefore was not enforceable in this case. Id. at 163.
102. Id. at 142-43.
103. Siebe Gorman, at 143.
104. Id. at 143.
105. Id. at 159.
the issue of when book debt proceeds were paid into an account that was not controlled by the chargee (be it a bank or some other credit institution). The court held that if the chargor was allowed to collect its book debts and place them in a bank account that was outside the control of the chargee, then the charge would be construed as a floating charge. This holding represented a movement away from favoring fixed charges over book debts as established in *Siebe Gorman*.

*Re New Bullas* placed a slightly different spin on the law of fixed charges, and it provided clarification for financial companies, other than banks, that were trying to create fixed charges over loans. The debenture between New Bullas and Lloyd’s Bank created a fixed charge over the uncollected book debts, but when the debts were collected, there was a floating charge over the collected debts. The court held that the debenture was a contract, and the fact that there was a floating charge over the collected book debts did not undermine the fixed charge on the uncollected book debts. The decision was made on a right to contract theory, stating that “unless some authority of law prevents them from agreeing, the agreement must prevail.” If the parties wanted to create such a debenture, the court was going to allow the debenture to stand.

In 2001, *Agnew and Another v. Commission of Inland Revenue* (hereinafter the “*Brumark*” case) threw the debate about fixed charges over book debts back up in the air. In that case, a debenture created between the company Brumark and Westpac Banking Corporation was written with the intention of creating a fixed charge

110. *Id.*
113. *New Bullas*.
115. *New Bullas*.
116. *See New Bullas* (commenting that if parties can contract to create fixed charges over book debts, then they are also able to contract for those fixed charges to become floating charges over book debts upon the collection of the book debts).
118. *Id.* ¶ 2.
over book debts arising in the ordinary course of business, and the
proceeds resulting from those debts.\textsuperscript{119} The debenture also said that
there was no a fixed charge over any proceeds that were received by the
company before the bank required them to be paid into an account at the
bank, or before the charge crystallized or was enforced.\textsuperscript{120} The
debenture did prevent the company from disposing of its uncollected
book debts, but it allowed \textit{Brumark} to deal freely with it assets,
including the proceeds of collected book debts, in the ordinary course of
business.\textsuperscript{121} The main issue was whether or not a lender could create a
fixed charge over uncollected book debts while allowing the borrower
to use the proceeds of the book debts freely in the ordinary course of
business.\textsuperscript{122}

The Privy Council\textsuperscript{123} held that because Brumark had control
over the proceeds of the book debts and was able to use them as they
pleased, the bank only had a floating charge over the assets.\textsuperscript{124} The
court stated that the intended control over the book debts was the crucial
factor in deciding whether a charge was fixed or floating.\textsuperscript{125} The
\textit{Brumark} case laid out a test to determine whether or not there was a
fixed or floating charge, which had two parts:

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 categorization. This is a matter

\textsuperscript{119} \textit{Id.} \S 3.
\textsuperscript{120} \textit{Id.}
\textsuperscript{121} \textit{Id.}
\textsuperscript{122} \textit{Agnew}, \S 1.
\textsuperscript{123} It is important to note that the Privy Council of New Zealand is made up of
members of the English House of Lords, the high court of England. Chalkiadis, \textit{supra} note
95.
\textsuperscript{124} \textit{Agnew}, \S 49.
\textsuperscript{125} \textit{Id.}, \S 32.
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.\(^{126}\)

In the end, substance controlled over the form of the agreement and it was necessary for there to be "sufficient post-collection controls on the use of the proceeds."\(^{127}\) In other words, the company should not be allowed to continue to use the proceeds of the book debts in the ordinary course of business for the charge to be classified as a fixed charge.\(^{128}\)

In contrast with New Bullas, the Brumark court held that having a fixed charge over uncollected book debts which became a floating charge upon collection was inconsistent with the idea of a fixed charge and therefore, the entire charge must be floating.\(^{129}\) The confusion created by the Brumark case, led to the current case at issue.

B. The Spectrum Plus Case

Spectrum Plus manufactured dyes, paints, pigments, and other chemical products for the painting industry.\(^{130}\) In 1997, Spectrum Plus opened a new bank account with National Westminster Bank ("NatWest").\(^{131}\) The account had an overdraft facility\(^{132}\) to provide working capital for Spectrum Plus.\(^{133}\) The overdraft facility had a limit of two hundred fifty thousand pounds.\(^{134}\) As security, Spectrum Plus gave NatWest a debenture that provided, in part, that National

126. Id., ¶ 32.
128. Id.
129. SJBerwin, supra, note 109, at 2.
131. Id. ¶ 2.
132. An overdraft facility is a line of credit extended by a bank to a customer who might overdraw the account. Black's Law Dictionary, supra note 24, at 1129.
134. Id. ¶ 3.
Westminster had a fixed charge over Spectrum Plus's book debts. Shortly after entering this agreement, Spectrum Plus was advanced two hundred thousand pounds, and from then on Spectrum Plus was in debt to NatWest.

On October 15, 2001, Spectrum Plus went into voluntary liquidation. At that time Spectrum Plus owed a total of £649,249, of which £165,407 was owed to NatWest, and £16,136 to Spectrum Plus's preferential creditors, according to Spectrum Plus's financial statement. When Spectrum Plus became insolvent, its book debts were valued at £291,293, and of that, insolvency practitioners estimated that £156,554 could be collected. At the time of this litigation, only £113,484 had been collected. The receivers refused to give NatWest any of the money collected from the book debts. As a result, NatWest brought this suit under §112 of the Insolvency Act of 1986 in the hope of a declaration that the debenture between it and Spectrum Plus created a fixed charge. If the debenture was found to create a fixed charge over Spectrum Plus's book debts, then NatWest would have been entitled to the £113,484 that had been collected.

The Chancery Court held that the debenture only created a floating charge. With this holding, the court reversed the Siebe Gorman v. Barclays Bank decision that initially allowed for fixed charges over book debts because the debenture in Siebe Gorman was almost identical to the one used by Spectrum Plus and NatWest. The

135. *Id.* ¶ 3.
136. *Id.* ¶ 4.
137. *Id.* ¶ 5.
139. *Id.* ¶ 5.
140. *Id.* ¶ 5.
141. UK ST 1986 c 45 Pt IV c V § 112. § 112 of the Insolvency Act of 1986 says in relevant part: "The liquidator or any contributory or creditor may apply to the court to determine any question arising in the winding up of a company, or to exercise, as respects the enforcing of calls or any other matter, all or any of the powers which the court might exercise if the company were being wound up by the court." *Id.*
143. *Id.* The Bank is seeking an "order on the liquidators to account to the bank in respect of [the book debts proceeds]." *Id.* At the time this case was brought, the proceeds of the book debts totaled £113,484. *Id.* ¶ 5.
144. *Id.* ¶ 39 (holding that Siebe Gorman incorrectly held a similar debenture to be a fixed charge over book debts, meaning that such a debenture only created a floating charge over book debts).
145. *Id.* ¶ 7.
judge refused to distinguish them\textsuperscript{146} based on the fact that Spectrum Plus’s account was always in the red while Siebe Gorman’s account was not.\textsuperscript{147}

The court began its analysis by looking at the definition of a floating charge as stated in \textit{Re: Yorkshire Woolcombers Association}\textsuperscript{148} which, in part, laid out three characteristics of a floating charge:

\begin{quote}
If it is a charge on a class of assets of a company present and future; if that class is one which, in the ordinary course of business of the company would be changing from time to time; and, if you would 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.\textsuperscript{149}
\end{quote}

Continuing, the relevant question was determined to be "[w]hether the charge when created contemplated that the company should continue to trade and should not until the occurrence of some specified future event be free to use in such trade the class of asset described as book debts."\textsuperscript{150} The \textit{Brumark} test was used to answer this question.\textsuperscript{151} In determining the rights and obligations that the parties intended to grant each other, regarding the book debts, it was held that the purpose of the debenture between Spectrum Plus and NatWest was to provide working capital for Spectrum Plus.\textsuperscript{152} The obligations created by the debenture were as follows: "(i) to pay the proceeds of any book debt into the company’s account with the bank, (ii) not to sell, factor, discount, or otherwise charge or assign the book debt in favor of any other person without the consent of the bank, and (iii) if called on,

\begin{itemize}
\item \textsuperscript{146} \textit{Id.} ¶ 17.
\item \textsuperscript{147} \textit{Id.} ¶ 15 (explaining the Bank’s argument that this case could be distinguished from \textit{Siebe Gorman}).
\item \textsuperscript{148} \textit{Re: Yorkshire Woolcombers Association} [1903] 2 Ch 284.
\item \textsuperscript{149} \textit{Spectrum Plus}, 2004 WL 61957, ¶ 10 (quoting \textit{Re: Yorkshire Woolcombers Association}, at 295).
\item \textsuperscript{150} \textit{Id.} ¶ 16.
\item \textsuperscript{151} \textit{Infra}, p. 5.
\item \textsuperscript{152} \textit{Spectrum Plus}, 2004 WL 61957, ¶ 35.
\end{itemize}
to execute legal assignments of such book debts."\(^{153}\) The court noted that the bank account was an ordinary clearing account, and like in *Brumark*, there were no limits on the company's ability to withdraw from the account.\(^{154}\)

Turning to the second part of the test, the court had to determine if the debenture created rights and obligations that were inconsistent with the nature of a fixed charge.\(^{155}\) It was held that the book debts were left under the control of the company in the ordinary course of business because there were no restrictions on the company's use of the proceeds.\(^{156}\) As a result, the intention given to the debenture was held to be inconsistent with the nature of the transaction as described by the parties with the fixed charge label.\(^{157}\) Based on the test, the Chancery Court held that the debenture between Spectrum Plus and NatWest did not create a fixed charge over Spectrum Plus's book debts.\(^{158}\)

The Court of Appeals reversed the Chancery Court's ruling, holding that the debenture did in fact create a fixed charge of Spectrum Plus's book debts.\(^{159}\) The court acknowledged that the debenture did not create a "total embargo on the manner in which the company may dispose of the charged assets,"\(^{160}\) but felt the bank exerted sufficient control over the assets for the charge to be a fixed one.\(^{161}\)

In an important aside, the Court of Appeals noted:

But for the obstacle of the decision in *Re New Bullas*, the decision of the Privy Council in *Agnew* would surely lead this court to the conclusion that an unrestricted freedom on the part of the chargor to use the proceeds of book debts charged necessarily means that the charge cannot properly be described as a fixed

153. Id.
154. Id.
155. *Id.* \(\S\) 37.
156. Id.
158. Id. \(\S\) 38.
159. See National Westminster Bank Plc. v. Spectrum Plus Ltd., 2004 WL 1074610, \(\S\) 98 (saying that he would allow the appeal that the Chancery Court refused).
160. Id. \(\S\) 4.
161. Id.
charge. Thus the effect of the debenture on the use that can be made of the proceeds of book debts is of vital significance.\textsuperscript{162}

In other words, the court felt that \textit{Brumark} was correct in focusing on the amount of control the chargor had over the book debts in the ordinary course of business.\textsuperscript{163} In the case at hand, however, determining the control over the book debts required consideration of \textit{Folly v. Hill}, which stated, "[M]oney, when paid into a bank, ceases altogether to be the money of the principal."\textsuperscript{164} That precedent led to the conclusion that once the book debts are paid into a account at the chargee's banks, the title to that money becomes the is vested in the bank.\textsuperscript{165} Under the strict control test of \textit{Brumark}, where the critical feature is the company's power to use the book debt proceeds in the ordinary course of business, the requisite degree of control to establish a fixed charge over book debts is ascertained by the fact that title to the money vests in the bank because the money is in the bank's account.\textsuperscript{166}

The Court of Appeals also noted it would have been inclined to uphold the concept of fixed charges over book debts under the doctrine of custom, as there is some need for stability in the law.\textsuperscript{167} It also commented that legislation in this area would be welcomed.\textsuperscript{168}

C. The Legal Status after the Spectrum Plus Court of Appeals Decision

The \textit{Spectrum Plus} case is currently on appeal to the House of Lords, the highest court in England.\textsuperscript{169} It is important to note that the application of the case is limited to circumstances where the chargee bank requires that the proceeds of the book debts be paid into an account \textit{with the bank}.\textsuperscript{170} There is no guidance in regard to the degree

\begin{footnotesize}
\begin{enumerate}
\item[162.] \textit{Id.} \textsuperscript{166} \textit{Id.} \textsuperscript{167} \textit{Id.} \textsuperscript{168} \textit{Id.} \textsuperscript{169} \textit{Id.} \textsuperscript{170}
\end{enumerate}
\end{footnotesize}
of control necessary to establish a fixed charge over book debts – for that, the Brumark case appears to be the test.\textsuperscript{171} New Bullas is also criticized a great deal in the Court of Appeals opinion in Spectrum Plus, and therefore has a high likelihood of being overruled by the House of Lords.\textsuperscript{172} Therefore, creating a debenture based on the New Bullas model may not be in a bank’s best interests.\textsuperscript{173} The essential point of all of these cases is that appropriate control must be exercised over the book debts at all stages – prior to collection and post collection to maximize a finding of a fixed charge.\textsuperscript{174}

V. ANALYSIS

Fixed charges over book debts have been considered problematic since Siebe Gorman first allowed them.\textsuperscript{175} While Siebe Gorman was controversial, the decision in Brumark threw what had become the fairly settled world of fixed charges over book debts “into a spin.”\textsuperscript{176} The Brumark decision created something close to a stand-off between banks and insolvency practitioners in the United Kingdom.\textsuperscript{177} The stand-off resulted from the banks believing that any proceeds of book debts collected were covered by their fixed charges and the insolvency practitioners doubting the fixed charges were effective under Brumark.\textsuperscript{178} All are now anxious for some certainty in this area.\textsuperscript{179}

The House of Lords’ decision, when forthcoming, should provide some of the desired certainty. The Court of Appeals noted that

\begin{itemize}
\item \textsuperscript{171} Id.
\item \textsuperscript{172} Id. (discussing that Court of Appeals criticism of the New Bullas holding that a chargee could have a fixed charge over book debts and a floating charge over the proceeds of the book debts, and advising that using a similar structure to the New Bullas one is not advisable at the moment).
\item \textsuperscript{173} Id.
\item \textsuperscript{174} Id. at 3.
\item \textsuperscript{175} Norton Rose, supra note 66, at 3.
\item \textsuperscript{176} See Chalkiadis, supra note 95, at 5 (discussing how Brumark turned the “settled world into a spin”).
\item \textsuperscript{178} Id.
\item \textsuperscript{179} See Spectrum Plus Limited (In Liquidation) – Court of Appeals Decision, Corp. Recovery (Pinsents, London, Eng.), May 2004, (on file with the North Carolina Banking Institute Journal) (commenting that it is unfortunate that there is lingering uncertainty is this area).
\end{itemize}
this was an "unsatisfactory area of the law" and said that "priorities should not turn upon the technical skill with which the bank accounting arrangements have been set up... this appeal may underlie the desirability of... legislation." That request for legislation that will provide more certainty appears to have been heard. The Law Commission for England and Wales recently released recommendations that have the potential to revamp English secured lending. These recommendations, if enacted into law, would provide more certainty than a House of Lords' ruling as any court decision may be limited to the facts of the particular case.

Among the many changes the Law Commission has recommended is the abolition of fixed and floating charges. This abolition would remove the distinction of fixed or floating, but retain the charge as a security interest. The charge would retain the commercial benefits of a floating charge. The notice filing system would also become similar to the U.S. Article 9 system under the U.C.C. Instead of determining priority by the type of security interest held, the recommendations allow for priority to be based on the date of filing. In regard to investment securities, priority will be given to the creditor who takes control, and there will be a definition provided for what constitutes possession by control. It is important to note that it has already been decided that control will not be the same as the control that must currently be exercised by a holder of a fixed charge.

Under the Law Commission's new system, fixed charges would
be abolished and all charges would have the characteristics of what once were floating charges. As a result, the case would come out similar to its initial ruling by the High Court. NatWest’s charge would not be fixed and therefore would rank behind preferential debtors. That would mean of the £156,554 collected from the book debts, £16,136 would be paid to the preferential creditors in this case, including the Inland Revenue, Customs & Excise, and employees. That would leave £140,418 to pay those creditors with a floating charge over the book debts, including NatWest. Out of that remaining money, the Enterprise Act also requires that roughly 20% be set aside for unsecured creditors, which means £112,335 would be left for those holding floating charges over the book debts. NatWest was owed a total of £165,407 when Spectrum Plus became insolvent. Under the Law Commission’s reforms, the bank would recover only £112,335, whereas with the fixed charge it intended to create, NatWest would have recovered £156,554. The change would mean instead of suffering a £8,853 loss, NatWest would suffer a £53,072 loss. While this may be the ideal result when considering the ease of the new system, banks would prefer to retain the fixed charge to prevent these larger losses.

VI. CONCLUSION

The small differences between the English and U.S. system of secured transactions may have a fundamental impact on a lender’s rights when a borrower becomes insolvent. With American banks

190. See id. ¶1.12.
192. McGuire Woods, L.L.P., supra note 1, at 3 (explaining that fixed charges “give the secured lender the greatest priority against competing claimants”).
194. See id. (subtracting the amount owed to preferential creditors £16,136 from the total amount of book debts collected so far £156,554).
195. See Moore Stephens, supra note 80 (explaining that about twenty percent of the net property remaining after preferential creditors are paid is set aside to pay unsecured creditors).
197. See id. (using the numbers provided to compare the amount collected and the amount that would be remaining after preferential creditors were paid, and twenty percent was set aside).
198. See id. (a restatement of the numbers figured in the previous sentence).
199. See Security Interests in Accounts Receivable and Inventory in Common Law and
setting up branches and subsidiaries in England, whether or not a bank has a fixed or floating charge over the chargor's book debts is an important issue. Having a fixed or floating charge over book debts will affect how much money the chargee may recover if the chargor becomes insolvent. 

Siebe Gorman established the concept of a fixed charge over book debts, and while it was always a controversial decision, Brumark rekindled the debate in earnest. Spectrum Plus is the test case to determine the status of fixed charges over book debts in England.

The crucial test for determining if a charge is fixed or floating focuses on control – one must consider if the chargor is free to dispose of assets without the consent of the chargee. If the chargor is free to dispose of the assets without permission, then the charge is floating, while if permission is necessary, then the charge is fixed. The major benefit of a fixed charge (and therefore negative of a floating charge) is that fixed charges have priority over preferential creditors and floating charges. Therefore most lenders would like to retain the current system that allows for fixed charges over book debts.

The English system of secured transactions, however, is entering a period of change. Both the House of Lords and the Law Commission are attempting to deal with this "unsatisfactory area of


201. See Charges over Book Debts, supra note 64, at 1 (discussing how fixed charges are paid off before preferential creditors or floating charge holders are paid).

202. See Clifford Chance, L.L.P., supra note 106, at 7 (explaining what was sufficient to create a fixed charge over book debts).

203. See Agnew v. Commission of Inland Review, [2001] 2 A.C. 710, ¶ 32 (explaining a new test for determining when there was a fixed charge over book debts – meaning that debentures following the established Siebe Gorman format no longer met the requirements for creating a fixed charge over book debts).

204. See Charges over Book Debts, supra note 64, at 2 (explaining that the Spectrum Plus case was brought as a test case to provide more certainty in this area).

205. BENJAMIN, supra note 23, at 105.

206. Id.

207. Chalkiadis, supra note 95, at 4.

208. See The Law Commission, supra note 183, ¶ 1.12.
law." With the House of Lord's decision in Spectrum Plus and the Law Commission's recommended changes to the law, there will be more certainty and simplicity when dealing with charges in England.\(^2\)

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\footnotesize
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  \item \textsuperscript{209} Spectrum Plus, 2004 WL 1074610, ¶ 99.
  \item \textsuperscript{210} See The Law Commission, \textit{supra} note 183, ¶ 1.12.
\end{itemize}