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The Legal Fabrication of Security Interests in the United Kingdom

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The Legal Fabrication of Security Interests in the United Kingdom

Iris H-Y Chiu†

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I. Introduction

The legal interpretation of security interests remains an important judicial activity in the United Kingdom, as recently manifested in the Re Spectrum Plus Ltd. decision in the House of Lords. ¹ Lawyers across the Atlantic, in the United States, and in most of in Canada would probably view this active role of the judiciary as unusual and have codified the law relating to security interests defining them in a functional way. Litigation has largely decreased under the conceptually clear personal property security system instituted by Article 9 of the Uniform Commercial Code (UCC) in the United States. ² Such clarity is desired in the United Kingdom and some hope that decisions like that in Spectrum could prevent costly litigation.

† Lecturer in Law, University of Leicester, United Kingdom. I would like to thank Will Shen for reading an earlier draft of this article and providing valuable comments.


The *Spectrum* decision was much anticipated for its potential to clarify when and how fixed charges may be taken over by accounts receivables, also known as book debts. However, this is only one instance of judicial interpretation defining the parameters of what may be permissible in commercial lending activity. Many issues in the interpretation of security interests remain open. One such question is whether a charge over present revolving assets, but not future revolving assets, would bring the charge within a fixed and not a floating charge even if the present revolving assets are now specifically appropriated to the charge.\(^3\)

In this paper, I will explain why the English law is to this date beset with issues concerning the interpretation of security interests, and suggest that the United Kingdom has been hesitant to fabricate security interests in the law. That is, as compared with more resolute approaches taken in the United States, Canada, and now New Zealand, in reforming the law on personal property security interests.

According to an interdisciplinary study law and anthropology, the legal system "fabricates" things in relation to persons\(^4\) which means that the relationship between persons and things is described in accordance with the legal language of rights in a given legal framework. This paper discusses the legal fabrication of security interests in the United Kingdom, or rather, the lack of fabrication, with particular attention to fixed and floating charges. This paper argues that in the United Kingdom, historical reasons gave rise to a delay in confronting the need to provide the legal interpretation of security interests. Until the policy of preferential creditors was given legislative force, there was no apparent need to fabricate security interests in the law. The policy resulted in a need to clearly define the terms fixed and floating charges as they led to different priorities among charge holders. The fixed charge

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\(^3\) The concepts of "fixed" and "floating" charges are unique to the United Kingdom and several commonwealth jurisdictions where English law has been transposed. More will be discussed in Parts II and III. See Re Atlantic Computer Systems Plc., [1992] Ch. 505 (C.A.) (exemplifying the issue of a fixed charge over present assets).

holder is prioritized above that of the preferential creditor, but the floating charge holder ranks below the preferential creditor. Hence, there is a need to fabricate security interests within the legal framework so that priorities of insolvency are clear. However, the need was not met by legislation, as legislators used the terms "fixed charge" and "floating charge" but did not attempt to define them. Legislation relies on the definition, of these terms as commonly understood. This is demonstrated by the Companies Act of 1900 through the Insolvency Act of 1986, which provided for the priority of preferential creditors to be ranked between fixed and floating charge holders with fixed charges to receive highest priority. The preferential creditor policy continues in the Enterprise Act of 2002, which amends parts of the Insolvency Act of 1986. The Enterprise Act of 2002 has removed some creditors from the preferential class. The Companies Act of 1989 provides for the registration of company charges so that they may not be void against the liquidator, and the relevant provisions of the Companies Act—which feature the use of the terms "fixed charge"—or "floating charge" do not provide legislative interpretation of those terms.

The unclear definitions of fixed and floating charge burdened the courts with the unenviable task of interpretation, which produced much case law. Some judges took a pro-commerce stance while some were mindful of the policy protecting unsecured creditors. The result was complex and detailed case law. There is still a general lack conceptual coherence of the fabrication of fixed and floating charges.

This paper argues that law of security interests needs a more coherent legal framework in three fundamental respects. First, the law must define security interests. Second, the law must provide the means of taking such interests and finally, the issue of priorities at insolvency must be resolved. The policy position

5 Dept. of Enter., Trade, and Inv., http://www.detini.gov.uk/cgi-bin/downutildoc?id=151.
6 Companies Act, 1900, 63 & 64 Vict., c. 48, § 14 (Eng.).
7 Insolvency Act, 1986, c. 45, § 59 (Eng.).
9 Id.
favors preferential creditors trumping certain security holders, and it is unfortunate that commercial lenders still try to side-step the policy by taking advantage of the weak legal fabrication of security interests. Commercial lenders attempt this side-step by framing their security interests into a type that would trump preferential creditors. The United Kingdom Law Commission has produced some recent recommendations on reforming the registration of company charges, recognizing that there is a wider need for comprehensive review of the law relating to security interests in general. However, the Commission has refrained from issuing recommendations that would significantly reform the first two aspects mentioned above.

In Part II, a general discussion provides an explanation of how U.K. law adopted a market-based approach to interpret fixed and floating charges, and never truly elucidated cogent legal fabrication. Part III discusses the effect of such a lack in fabrication, resulting in judicial attempts to interpret security interests, particularly fixed and floating charges by bundling several concepts. These concepts relate to the definition of a security interest, the means of taking of a security interest, and priorities at insolvency. This paper argues that the bundling approach is unsatisfactory compared to the “unbundled” approach used in the United States, and adopted by Canada and New Zealand. Part III argues that legal fabrication of fixed and floating charges, if not of all security interests, should be undertaken by first unbundling the three concepts of definition of security interest, means of taking of security interest, and priorities, and then any relationship between the three concepts can be clearly defined. Part III.A will examine the United Kingdom’s bundling approach to interpretation and Part III.B will examine the American approach of fabrication of security interests by unbundling the concepts of definition, means of taking, and priorities. Part III.B will reveal that the American approach has more to it than meets the eye. Part IV discusses the prospects of

11 Law Commission, Company Security Interests, ¶ 1.70, 3.175 (Cm 6654) (2005), http://www.lawcom.gov.uk/docs/lc296.pdf. The Law Commission is an independent body whose task is to systematically study possibilities of law reform. It also issues recommendations to the government to provide reform legislation.

12 See id.

13 Id.
legal fabrication of security interests in the United Kingdom and whether that may be provided for by legislation, case law, the market, or academics.

II. The Genesis of the Interpretation of Security Interests

A prominent commentator remarked that English law has always adapted well to commercial needs, demonstrating flexibility and giving effect to reasonable practices in commerce. This is also the case for the law of secured credit in its evolution as primarily judge-made private law. Another prominent commentator pointed out that there are several qualities of such judge-made private law that lie beneath the endurance and popularity of the law. These qualities are: the permissive character of the law to allow the taking of the widest range of assets as security, especially favorably disposed towards non-possessory security, the existence of simple means for creation of such security interests, existence of rules for effective publicity to third parties, and the relatively straightforward self-help mechanisms for enforcement against such security upon default.

The development of the securities law in the United Kingdom is a response to market needs. Therefore, the law of security interests is market-based and affirms the constructs provided by the market. First, the law is generously permissive concerning what may be taken as security. The law's tolerance of expansion in security, whether by deliberate engineering or not, fits well with anthropological observations about the development of commerce.

Both John Locke's political economy theories celebrating private property and the growth of capitalism, which celebrates

14 See Roy Goode, Commercial Law in the Next Millennium 31 (Sweet & Maxwell 1998).
16 In this area, many civil law jurisdictions still struggle with the perception that non-possessory security interests, may result in fraud upon creditors. Therefore this fear still restricts the growth and expansion of security. See Philip Wood, Comparative Law of Security and Guarantees 4-6 (Sweet & Maxwell 1995).
17 See McCormack, supra note 15.
18 See generally, John Locke, Two Treatises of Government (P. Laslett ed., Cambridge Univ. Press 1967) (1960); see also Charles Taylor, Hegel and Modern Society (Robert B. Pippin ed., 1979). These works are all quoted and discussed
ownership of property, have become resilient "cultural memes" that dominate the Western cultural views of property. The ability to create various relationships in property would facilitate various forms of commercial dealings. Even before the industrial revolution, medieval law observed a range of relationships between people in relation to things. With increasing industrialization, the output of things has increased dramatically and the relationship between people and property has developed with more sophistication. In particular, relationships between people include more and more types of property as well as divisions of interests in this property. In addition to that, increased commodifying of various items allows more and more objects to be regarded as property where interests and divisions of interests could arise.

With the rise of the joint stock company, enterprise, and

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19 KATE DISTIN, THE SELFISH MEME 1-255 (2005) (developing the idea of the meme as a "cultural gene"). In this book, Distin argues that cultural "genes," otherwise known as memes, store cultural information specific to its times and environment, and develop to survive in changing environments, resulting in a process of cultural evolution. Thus, her theory suggests that culture evolves quite similar to biological evolution in the Darwinian thesis. Id.


22 In economic anthropology, it is thought that there are a few stages of development with respect to the relationship between man and things. Capitalism, or the explosion of assets that may be accumulated to make profit, is a recent stage. See generally Stephen Gudeman, The Anthropology of Economy: Community, Market, and Culture (2001). Gudeman divides the stages of economic anthropology into four categories: (1) the base, where a community shares natural resources; (2) allotment, where individuals start to apportion property rights and use them as gifts or exchange within the family; (3) exchange, where such property rights may be given or exchanged with external members of the community; and (4) capitalism, where property and exchange exploded and could be carried out with anyone at large and in a depersonalized manner. Id. at 7-8.

23 Marilyn Strathem, Division of Interests and Language of Ownership, in PROPERTY RELATIONS, supra note 20, at 214 n.15.

increased commerce, the growing need for credit and consequent need for putting up security\(^\text{25}\) meant that expanded notions of property were put into play. The notion of security expanded in terms of the type of proprietary subject matter that could be used, as well as myriad divisions of interest in subject matter.\(^\text{26}\) Jean-Christophe Agnew, a leading anthropologist, opines that the development of commerce took place as “episodic acquisitions” giving way to a “continual flow of value and service.”\(^\text{27}\) This is similar to the development of credit in that credit is not seen as the episodic need of an enterprise, but a continual occurrence on the

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\(^{26}\) Such as the development of the floating charge.

balance sheet of the life of the enterprise. Credit is a fact of life necessitated by the chains of supply, delivery, and retail, as well as the time lags between turnovers.\textsuperscript{28} The development of big-ticket financing and the time lag between outlay of capital and returns also necessitated a growth in credit.\textsuperscript{29} The growth of credit triggered the increase in types and varieties of security instruments used to secure such credit. Expansions in the definitions of property enabled this notable enlargement in conceptions of security instruments.\textsuperscript{30}

The role English law played in the development of commerce was a facilitative one. Private law provided the legal framework for property notions in security.\textsuperscript{31} Additionally, judges largely allowed creation of security interests over a wide array of subject matter, including future property,\textsuperscript{32} and allowed the floating charge to secure the continual undertaking of the business if the business did not have more specific assets to charge.\textsuperscript{33} Thus, the law not only allowed the taking of security over novel forms of assets but also recognized novel interests \textit{in rem} to most expediently facilitate commerce. Even the now overruled cases of \textit{Siebe Gorman}\textsuperscript{34} and \textit{In Re New Bullas Trading Ltd.}\textsuperscript{35} (as will be

\textsuperscript{28} Id.
\textsuperscript{29} Id.
\textsuperscript{30} See Goode, Security in Cross-Border Transactions, supra note 25.
\textsuperscript{31} Much of early private commercial law was derived from commercial practices generally accepted by merchants, although whether there was truly a body of \textit{lex mercatoria} is in some controversy. See generally Charles Mitchell, History of the Law Merchant (1904) (detailing the rise of mercantile law, but holding the view that such law is absorbed into national law rather than constituting a law of its own as the nature of mercantile law in different jurisdictions remained disparate for quite some time); Clive M. Schmittoff, Nature and Evolution of the Transnational Law of Commercial Transactions, in The Transnational Law of International Commercial Transactions (Norbert Horn & Clive M. Schmittoff eds., 1982); Filip de Ly, International Business Law and Lex Mercatoria 317-21 (1992) (arguing that there is no such thing as a real \textit{lex mercatoria}); see also Clive Schmittoff, International Business Law: A New Law Merchant, 2 Current L. & Soc. Probs. 129, 131-35 (1961) (making modern commentary on whether there is a \textit{lex mercatoria}).
\textsuperscript{34} Siebe Gorman & Co. Ltd. v. Barclays Bank Ltd., (1979) 2 Lloyd's Rep. 142 (Ch.D.).
discussed in Part III) manifested a pro-commerce attitude in allowing freely contracting parties to divide and delineate their rights over subject matter in novel ways.

Second, judges did not fabricate security interests in their own legal language, but rather adopted the commercial fabrications of security interests. There was, in other words, very limited reframing of the contractual security agreement between parties. Even if sale and lease-back arrangements may be a form of secured financing in substance, sales and lease-backs were treated as transfer-of-title arrangements rather than security arrangements, fully respecting parties' freedom of contract. In terms of English commercial law, arguably, the law of security allowed the fabrication of security interests largely in tandem with commercial desires, and did not straitjacket such fabrication with legal principles. This is unlike the approach of continental European jurisdictions that judge the acceptability of security transactions according to fundamental legal values such as the "false wealth" principle. Therefore, in many continental jurisdictions, non-possessory security is largely not allowed due to fear of fraud. In sum, the legal fabrication of security interests in the United Kingdom was limited as such fabrication responded to and relied on commercial fabrication instead of leading. In the case of fixed and floating charges, i.e., in the early case of In re Panama, New Zealand and Australian Royal Mail Company where the floating charge began, the court performed a more descriptive than prescriptive function. Similarly, the Companies Act of 1900 provided that the non-registration of a floating charge was void


36 The famous Romalpa clause is also an instance of the judiciary accepting the commercial fabrication of a transaction. Roy Goode, Legal Problems of Credit and Security 7 (2d ed. 1988).


38 Franco-Latin jurisdictions such as France continue to remain rather skeptical about the acceptability of various forms of non-possessory security. See id. ¶ 1-7. In Italy, adoption of the concept of chattel mortgages is also slow, and reliance is placed more heavily on a lien system and systems where ownership structures are used such as leasing and factoring. See Ferranini, supra note 25, 483-90.

39 See In re Panama, New Zealand and Australian Royal Mail Company (1870) 5 Ch. App. 318.
against liquidators but did not define what the floating charge was.\(^{40}\)

In *In re Panama*, Lord Justice Sir Giffard interpreted a charge over "all undertakings of a company" as effective against all of the company's property at the point of default. This totally excluded unsecured creditors from recovery.\(^{41}\) In that case, the learned Lord Justice did not fabricate the charge in any conceptual terms and agreed with the security instrument that it was a charge over the company's entire undertaking.\(^{42}\) Thus, the case focused on affirming the validity of such a security instrument as parties had intended, and no further effort was made to fabricate the security interest within a legal framework. In *In re Yorkshire Woolcombers*,\(^{43}\) Lord Justice Williams asserts that in *Government Stocks and Other Securities Investment Co. v. Manila Ry. Co.*,\(^{44}\) Lord Macnaghten distinguished between a fixed and floating charge. Lord Williams said that a fixed charge was taken over subject matter that is specific and ascertainable or was in its nature capable of immediate fastening on the asset, while the floating charge had a hovering character and usually related to a class of assets or present and future assets.\(^{45}\) As will be argued in Part III, however, this is an early form of conceptualization or fabrication that unfortunately did not give rise to the development of clearer legal fabrication. The lack in clear legal fabrication subsequently resulted in the "bundling approach" taken in later case law with regard to the legal interpretation of fixed and floating charges.

The ease with which judges developed the private law framework for credit and security may perhaps be explained by a dominant reliance on the doctrine of freedom of contract.\(^{46}\) This doctrine would allow the individual contracting parties to enforce the terms of what they have bargained for without much external

\(^{40}\) Companies Act, 1900, 63 & 64 Vict., c. 48 (Eng.).

\(^{41}\) *In re Panama*, 5 Ch. App. at 321-23.

\(^{42}\) *Id.*

\(^{43}\) *Re Yorkshire Woolcombers Ass’n Ltd.*, (1903) 2 Ch. 284, 291.


\(^{45}\) See *id.*

Thus, the approach of English private law to credit and security was both minimal and formal. Arguably, judges took the minimal approach manifested in the facilitative approach and allowed assets that could provide a right *in rem* to be treated as security. This minimal approach also allowed for a more formal approach to security, allowing different commercially fabricated instruments to be regarded as they were, without further legal reconceptualization. This led to legal compartmentalization in the law with regard to different financing arrangements. There were hardly any unifying concepts with regard to security interests.

The freedom of contract between lender and borrower did not seem to provide an optimal lending solution in the market. Externalities arose in the process as individual secured lenders became more protected than other unsecured creditors of the borrower. Secured lenders could enforce against a particular security and could effectively remove the security from the pool of assets left in insolvency. It could be argued that the priority of secured lenders subverted the final *pari passu* division of the borrowers' assets upon insolvency. Furthermore, unsecured lenders had no opportunity to intervene in the "freedom of contract" to protect their rights. These are issues of redistributive

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47 See id., at 226-37; Grant Gilmore, The Death of Contract (1974). The notion of "freedom," is assumed to be individual, positive freedom. One critic examines this notion of freedom in light of negative forms of freedom and net social increase in freedom for others where individual freedoms are restricted. If more notions of "freedom," particularly social freedom, were discussed, then the "freedom" of contract may not be given an aura of greatness that is beyond its actual narrow confines. See Mark Pettit, Jr., Freedom, Freedom of Contract, and the "Rise and Fall," 79 B.U.L. REV. 263, 352-54 (1999).

48 For example, retention of title clauses and hire purchase continue to be regarded as issues of when ownership passes rather than that the seller has retained security in the goods until payment is made in full.


51 Unsecured creditors play no part in the compacts between borrowers and secured creditors.
justice or fairness. Professor Elizabeth Warren argues that the taking of security and improvement of a creditor's position by contract may be in the freedom of contract, but such freedom impinges on the rights of other creditors, especially involuntary unsecured creditors who rely on the final pari passu division of the insolvent's assets. If full priority is granted to secured creditors, the law on security takes away state regulated rights at insolvency. Further, due to a lack of information, the affected unsecured lenders would hardly know that loan negotiations were taking place between the debtor and secured lenders, therefore unsecured lenders would not likely be able to intervene to protect their rights. Regulation is needed to correct this market failure.

Unsecured creditors in the United Kingdom also exerted political pressure, which resulted in statutory inroads into the freedom of contract between secured lenders and borrowers. The high priority status of secured creditors was modified by subordinating floating charge holder claims to preferential creditors in the late nineteenth century. Such preferential creditors were the Crown and the crew. Therefore, policy dictated that not all secured lenders had full priority at insolvency and some creditors, although unsecured, would be able to rank ahead of some secured lenders.

However, after the policy came into force, the general observation was that as companies failed they frequently postponed their debts to the Crown and crew to such an extent that upon liquidation, fixed charge holders and preferential creditors generally took all that the company had left and floating charge

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52 See Warren, supra note 50.

53 See id.


55 The Crown referred to the Inland Revenue, Customs and Excise and Office of Social Security; the crew referred to employees.

56 The policy would therefore seem to be based on externality justifications that create inroads into the freedom of private bargains. Externalities do not always justify imposing limits on the contractual bargain privately struck. See Michael J. Trebilcock, The Limits of Freedom of Contract 58-77 (1993) (discussing the externality analysis); Alan Schwartz & Robert E. Scott, Contract Theory and the Limits of Contract Law, 113 Yale L.J. 541, 550-68 (2003) (explaining the externality analysis is also supported by efficiency arguments in contract theory).
holders were left with a security that was not worth much.\textsuperscript{57}

As floating charge holders suffered, the attractiveness of the floating charge subsided. Lenders tried to frame their security interests as fixed charges, even over assets or divisions of interests in assets that might not have traditionally been subject to fixed charges.\textsuperscript{58} Lenders took advantage of the fact that the framing\textsuperscript{59} of the preferential policy in the legal framework was rather unfortunate. The policy was framed in terms of the language of the market, namely that the policy identified fixed and floating charge holders but made no attempt to define or redefine them, and relied on the interpretations of the fixed or floating charge in the market. It has already been argued that those interpretations in law were not clear, and Lord Millett expressly acknowledged that the early notion of the "floating charge" was a business term and not a legal term of art.\textsuperscript{60} Thus, the market took advantage of the lack in clarity to push the interpretational parameters of the fixed charge. Consequently the judiciary had to wrestle with the interpretive minutiae of what made a fixed charge in one case or another. Judicial interpretation was influential in the litigation relating to fixed charges over book debts (as will be discussed in some detail in Part III). In this process, the judges only dealt with cases at hand and were constrained by factual situations. As a result, they have been unable to articulate a "big picture" conceptualization of the law of security.

When the United Kingdom did not need legal fabrication of security interests, the level of fabrication was consistently low. The permissive climate allowed most assets to be taken as security and most agreements were respected for the structure they took as long as they were not offensive to public policy. There was no real need to fabricate security interests with great precision.


\textsuperscript{58} See infra Part III.A for discussion.

\textsuperscript{59} The framing of an issue is a highly important undertaking as it affects the assumptions that may or may not be made regarding that issue, and provides the lenses through which an issue could be viewed. \textit{See generally Robin Paul Malloy, Law and Market Economy} (2000) (arguing this semiotic understanding of law’s role in a market economy); \textit{Robin Paul Malloy, Law in a Market Context} 26-55 (2004).

\textsuperscript{60} See Agnew & Another v. Comm’r of Inland Revenue Privy Council, [2001] 2 A.C. 710, 719.
However, the policy of preferential creditors forced the clearer delineation between fixed and floating charges, and prompted the interpretation exercise. This resulted in the judicial bundling of the three aspects of a security interest definition, the means of taking of a security interest, and priority issues at insolvency.

III. Legal Fabrication of Fixed and Floating Charges—Bundling and Unbundling

As discussed, lenders tried to construct their security interests as fixed charges so that they would attain a superior position to preferential creditors at insolvency. Upon litigation, the courts had to characterize the nature of the security interest in terms of law, which was potentially at odds with the parties’ expressed wording on the charge documents. An abundant area of litigation occurred in relation to fixed charges over book debts (otherwise known as accounts receivables). Book debts are revolving assets that should have been suitable subject matter for the floating charge. Book debts are also commonly used as security because many businesses do not have any other substantial asset to offer as security. Hence, book debts have become a major source of security for credit financing, and lenders have tried to frame their security over book debts as a fixed charge in order to trump preferential creditors in the event of insolvency. However, whether and to what extent fixed charges may take over a revolving asset such as book debts became a hotly contested issue between lenders and liquidators. This issue surfaced in 1979 and was not settled by the House of Lords until June 2005.

Defining fixed and floating charges has raised concerns among


62 See Street v. Mountford, [1985] A.C. 809, 826. See also GOODE, supra note 14, at 3-29, in which Professor Goode opines that English courts generally give effect to parties’ intentions, and are responsive to commercial needs as long as the market practice is not unreasonable. However, courts would still not rubber-stamp parties’ intentions if parties had made odd characterizations. In fact, how the court would construe a charge instrument now is a matter of law in two stages, first to determine the nature of the rights parties intended to create, and then it is for the courts to categorize that into the type of security interest most appropriate under law. See Re Brumark Inv. Ltd., Agnew v. Comm’r of Inland Revenue, [2001] 2 A.C. 710, 725.

63 See infra Part III.A.
policy-makers who recognized that the insolvency policy gives some creditors preferential treatment. The legislature has enacted the Enterprise Act of 2002 to reduce the pool of preferential creditors by removing the Crown from the pool but not actually abolishing the concept altogether. Therefore, it has minimally improved the attractiveness of the floating charge and prevented lenders from trying to fit into the fixed charge as many arrangements as are possible.\(^{64}\)

The uncertainties surrounding the fixed and floating charge are not a satisfactory state for commercial law, as one of the needs of a competitive jurisdiction is the predictability of its commercial laws.\(^{65}\) If commercial lenders cannot be sure of the nature of security they have taken, that may affect lending decisions and the availability of credit. However, it is inherent in any legal system that there would be gaps. Thus, balanced against the inherent nature of any legal framework, would the uncertainties in English law in the nature of fixed and floating charges be regarded so adversely? However, the way forward, as identified by Lord Millett, is "legal interpretation" of security interests. The chief weakness of the security law in the United Kingdom has at last been identified as the lack of clear legal fabrication of security interests.\(^{66}\)

The legal interpretation of security interests in the United Kingdom has thus far occurred under a "bundling" approach. This approach allows the definition of the nature of security to be affected by issues relating to means of taking security as well as priority at insolvency. This paper argues that this approach may be the root cause of a great deal of all the litigation and unresolved definitions.

In contrast, the American approach is to decouple the issues of: (1) the nature of a security interest; (2) the means of taking a security interest; and (3) priority at insolvency, so that a system of personal property security may be constructed using simplified

\(^{64}\) It remains to be seen how far the Enterprise Act of 2002 may alleviate the interpretation difficulties between fixed and floating charges. See Capper, \textit{supra} note 54. Gerard McCormack thinks the Enterprise Act of 2002 would not help towards resolving the definitional issues in fixed and floating charges. See Gerard McCormack, \textit{The Nature of Security Over Receivables}, 23 Co. Law. 84, 86 (2002).

\(^{65}\) Predictability is valued in commercial law. See \textit{Goode}, \textit{supra} note 14, at 14-16.

and clear concepts. The prescriptions are set out in a code, and such legal fabrication provides a comprehensive framework for commercial developments. It is a proactive approach, albeit with room for future responses.

The relative clarity achieved under the American system is argued to be sound, and even if the United Kingdom does not adopt U.S. Article 9 of the Uniform Commercial Code, the methodology of unbundling may be the answer towards a clearer legal fabrication of security interests, in light of the United Kingdom's inexorable march towards "interpretive substance," as called upon by the Law Lords in the Brumark and Spectrum cases.  

A. The Bundling Approach in the United Kingdom

The United Kingdom's bundling approach relates to the interdependence between the subject matter of the security, and the manner of its "taking"—or in more technical terms, "attachment" and "perfection" of the security interest—and the relationship between the definition of a security interest and issues of priority in insolvency. This is examined in relation to the legal fabrication of the floating charge.

First, I will look at one of the earliest definitions of the floating charge from In Re Yorkshire Woolcombers. A floating charge is defined in the following extract, although the judge has expressly said that the defining features of floating charges are not meant to be exhaustive and that all of the characteristics need not be present:

I certainly do not intend to attempt to give an exact definition of the term 'floating charge', nor am I prepared to say that there will not be a floating charge, within the meaning of the [Companies] Act [1900], which does not contain all the three characteristics I am about to mention, but I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be

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67 See infra Part III.A for detailed discussion.

68 For a detailed explanation of "attachment" and "perfection." See McCormack, supra note 49, at 70-71; see also McCormack, Secured Credit, supra note 25.

69 See Yorkshire Woolcombers, [1903] 2 Ch. 284, 288.
changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.\textsuperscript{70}

The three characteristics in \textit{In Re Yorkshire Woolcombers} refer to the type of subject matter the charge may take over, that is, "present and future" assets, or a continuous flow of assets, that change from time to time. The nature of the assets allows turnover and relatively quick replacement of the same type of subject matter. Next, the definition refers to how the security interest is taken, and only at a point in time to which the parties agree the exact pool of assets would be attached to the secured lender (otherwise known as "crystallization"). Thus, the classic definition of the floating charge already bundles up the nature of the subject matter that could be subject to a floating charge with the manner of its taking to determine if a floating charge exists. There is nothing objectionable about this if the conceptual definition of the floating charge results in a marriage of the two components. However, as there are two components, whenever grey areas are encountered, lawyers would dissect the two components in order to weigh which matters more to the definition. This is the weakness of the definition: no conceptual thought has been given to the exact relationship or weight of the two components relative to the other. This is manifested in the examples of case law discussed below.

In \textit{Re Atlantic Computer Systems Plc.},\textsuperscript{71} an assignment of current rent benefits was collected for equipment that was leased out. This assignment was regarded as a fixed charge, as the charge dealt with "present" and not "present and future assets." However, the rent benefits were not attached to the secured lender as they were collected and would be used in the ordinary course of business until default occurred. Therefore, the rent benefits were a type of revolving asset and not a specific asset. One would have thought that the revolving nature of the asset would make the charge a floating one. However, the court held that as the assignment dealt with "present" assets, this was sufficient for a

\textsuperscript{70} \textit{Id.} at 295.

\textsuperscript{71} \textit{See} \textit{Re Atlantic Computer Systems Plc.}, [1992] Ch. 505 (CA).
fixed charge. The nature of the charge in this case depended on the nature of the present assets and not the manner of taking. Many commentators doubt the correctness of this case, but it highlights the difficulty one faces in applying a definition which is plagued with grey areas.

In *Holroyd v. Marshall*, the court allowed future machinery to be taken under a fixed charge. Because it could be described with specificity and had relative permanence, the machinery could be attached to the charge once it came into being. This level of specificity in the asset created a valid fixed charge, even though the future machinery did not yet exist. In *Re Cimex Tissues*, the chargor had the relative freedom to deal with the forklift truck subject to the charge, including the sale and mortgage of the truck. Here, the chargor could use the assets as if they were unencumbered, as though those assets were under a floating charge. The court held that the charge was fixed because the nature of the asset was specific and it could attach to the charge immediately. Thus, in *Holroyd* and *Re Cimex Tissues*, the type of subject matter was more important than the degree of chargor control over the assets in determining whether there was a fixed charge.

In *Re Cosslett Contractors Ltd.*, the opposite conclusion was reached with respect to a charge over a class of assets including a coal washing plant. The charge was held to be floating because the chargor had freedom to remove the plant without the chargee's consent, even though the coal washing plant was sufficiently specific and could attach immediately to the charge. That case turned on the degree of chargor control rather than on the nature of the asset.

The testing of the *Yorkshire Woolcombers* bundled definition of the "floating charge" was perhaps most severe in the book debt cases. The history of the book debt cases started with *Siebe Gorman & Co. Ltd. v. Barclays Bank Ltd.*, in which a purported

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75 See *Re Cosslett Contractors Ltd.*, [1998] Ch. 495, 501.
fixed charge was taken over the company's present and future book debts. The book debts had to be paid into a specified account with Barclays Bank, the lender, and although there were no express restrictions on the company's use of the proceeds in the account, Judge Slade thought that the chargee bank could impose restrictions, as it was within its power to do so and therefore had sufficient control over the proceeds. The potential of the chargee's power to control the proceeds sufficed to create a fixed charge. In the later case of Re Keenan Bros., the Irish Supreme Court refused to find a fixed charge over book debts unless there was express control over the account by the chargee with respect to the proceeds that were paid into the account. This was affirmed in Re Brightlife. It seems that clearing banks had an advantage when taking security over book debts. Here, clearing banks could more easily argue that they had control over the account that the book debts were paid into, and therefore the clearing banks had a fixed charge over those debts. Non-clearing banks would find it difficult to argue that they had a fixed charge if they could not effectively control the proceeds of book debts collected by the chargors. However, it was not clear what degree of control over proceeds sufficed for a charge over book debts to be a fixed charge. In Siebe Gorman, the judge opined that the possibility of chargee control sufficed as actual control, but this was rejected in Keenan Bros. and Brightlife. Consequently, if we accept that some form of actual control is needed over the account for the chargee to have a fixed charge over the book debts in that account, how would actual control be arranged in light of the chargor's need to access the proceeds for day-to-day business operations? The following inquiries must be made: (1) would the chargor have to ask for permission at each withdrawal; (2) could the chargee

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80 Christopher Brown, Re New Bullas Trading Ltd.—When is a Fixed Charge Not a Fixed Charge, 8 J. INT'L. BANKING L. REG. 381, 388 (1993).
81 Oditah, supra note 79; see also Robert A Pearce, Fixed Charges over Book Debts 18 J. BUS. L. 18, 29 (1987) (giving academic affirmation to the creation of fixed charges over book debts but warning that control over proceeds has to be provided to secure a fixed charge for the chargee).
give blanket consent; (3) could the chargee arrange for monies to be released in fixed amounts over periods of time; (4) would it be sufficient if the chargee ensured that the account was not overdrawn?

In *Re Brumark*, a Privy Council case from New Zealand, it was stated that only a blocked account, operated in fact and not by name, would suffice as sufficient control for a fixed charge over book debts to be taken. Questions regarding the mechanics of the blocked account remained as no definition for the blocked account was provided. In *In Re Spectrum Plus*, the House of Lords finally defined what a blocked account is, stating that it should be a specified account where the proceeds are kept for the security of the chargee and such monies should be frozen and not be at the disposal of the chargor, without the written consent of the chargee. The definitional issue seems to have been resolved by the House of Lords’ specific pronouncement on what suffices as control of book debts to be sufficient for a fixed charge.

Understanding the issues regarding the nature of a security interest and the taking of the interest is essential to identifying

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82 Jessica Young, *Charge over Book Debts: Siebe Gorman Revisited*, 15 INT'L CO. 


85 Oditah, *supra* note 79.


87 The Court of Appeal in *Spectrum*, [2004] EWHC 9; [2004] 1 All E.R. 981, upheld the fixed charge over receivables as the receivables could not be disposed of or assigned but could only be collected. The proceeds were to be paid into a specified account without further controls. The Court of Appeal’s holding is based on two assumptions. First, the Court was bound by the earlier case of *Re New Bullas* on a similar charge instrument. Second, the Court considered that *Siebe Gorman* allowed for the proliferation of commercial expectations that fixed charges could be quite easily taken over book debts, and it would not be in commercial interests to disrupt that. The *Spectrum* decision in the Court of Appeal has been supported by Alan Berg, who argues that if a debtor were required to pay the collected proceeds into a bank account and that account was always overdrawn, the money paid in was always used to satisfy the overdraft debt. The overdraft facility could be stopped by the bank; therefore, the bank had ample control over the proceeds, which made the charge over the proceeds fixed in *In Re Spectrum, supra* note 1. This is distinguished from *Siebe Gorman* where the account was in credit. *See Fixed Charges Over Book Debts: Spectrum*, 17 INSOLVENCY INTELLIGENCE 33 (2004); Alan Berg, *Charges Over Book Debts: The Spectrum Case in the Court of Appeal*, J. BUS. L., 2004, at 581, 587.
difficulties in determining whether a charge over book debts is a fixed charge. Book debts have a continuous and revolving nature, satisfying the first two elements of *In Re Yorkshire Woolcombers*. Therefore, whether the charge over book debts is fixed or floating depends on the third element dealing with means of taking.\(^8\) The third element seems to suggest that the floating charge is characterized by the chargor’s freedom to deal with the pool of assets; therefore, the converse must be true in that limits to such freedom would make the charge a fixed charge. Commentators\(^9\) and the Law Commission\(^10\) accept that the degree of control over the asset was key to whether a fixed or floating charge was created over book debts. However, if book debts were to be identified and attached specifically to the secured lender, then many businesses relying on book debts to facilitate their cash flow would be seriously affected. Therefore, lenders and borrowers tried to find a balance between allowing the lenders sufficient control over the proceeds of the book debts and allowing businesses to have access to the proceeds. Academics,\(^11\) practitioners,\(^12\) and the judiciary split hairs over what is sufficient control to satisfy the requirement of the fixed charge,\(^13\) rendering the definition confused and complex.\(^14\) Although the exact mechanics of control have now

\(^8\) Andrew McKnight, *Brumark: The Difference Between Fixed and Floating Charges*, 16 J. INT’L. BANKING L. REG. 157, 158 (2001). In fact, Professor Sarah Worthington is of the view that degree of control is the only simple and explicit criterion for distinguishing between fixed and floating charges. See Sarah Worthington, *Fixed Charges over Book Debts and Other Receivables*, 113 L. Q. REV. 562, 562 (2001).

\(^9\) Worthington, supra note 88; Oditah, supra note 79.

\(^10\) Law Commission, supra note 11, ¶ 3.159-60.


\(^12\) Practitioners Stephen Atherton and R.J. Mokal came up with nine complex guidelines for distinguishing between fixed and floating charges. See Stephen Atherton & R.J. Mokal, *Charges Over Chattels: Issues in the Fixed-Floating Jurisprudence*, 26 Co. LAW. 10 (2005); see also Young, supra note 82.


\(^14\) Furthermore, there was also the argument that control over book debts should not depend on post-contractual conduct but on pre-contractual agreements. It is unusual to depend on post-contractual conduct in ascertaining parties’ intentions to a contract. See Oditah, supra note 79; G. McMeel, *Prior Negotiations and Subsequent Conduct—The Next Step Forward for Contractual Interpretation*, 119 L. Q. REV. 272 (2003); M.
been settled by *Re Spectrum*, the case has made the fixed charge over book debts an extremely unattractive option for lenders and borrowers, as it provides that absolute control is needed for a fixed charge over book debts.

It could be argued that absolute control is not itself an essential characteristic of many fixed charges held good under U.K. law. In *Re Cimex Tissues*, the chargee allowed the chargor to have a certain extent of freedom in dealing with the forklift truck subject to the charge. Further, in fixed charges taken over future property, the fact that future property is not in existence and acquisition depends on the chargor’s discretion, this signifies that the chargee does not have absolute control over the asset. To require absolute control over book debts seems too stringent for the requirements of the fixed charge, as other precedents have shown more flexibility. It remains to be seen whether the parameters laid down in *Re Cimex Tissues* will adversely affect commerce.

*Spectrum* shows that legal fabrication of security interests in the United Kingdom is still weak under the bundling approach. There has been no attempt to explain how the conceptual definitions of security and means of taking are bundled, if they should even be bundled at all. Furthermore, the bundling approach in the United Kingdom handicaps the development of U.K. law with respect to new ideas in taking security. For example, security interests could provide for shared or convertible forms of control over the security. A charge which was drafted as fixed under certain conditions would become floating under other conditions. How would the law regard such a charge? This kind of charge would defy the traditional categories of fixed and floating charges. Would the law be able to accommodate these novel commercial developments? Where practitioners are concerned, the label of the instrument is not as important as its results. Therefore, is the law too archaic for the needs of commerce because it subjects novel instruments to traditional categorization? In the alternative, could it be argued that it is the

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lenders and borrowers that have to be disciplined through limits on when they could give or obtain credit.\textsuperscript{97}

I will discuss the bundling approach taken in respect to the issue of defining security interests and priorities at insolvency. An innovative, but ultimately rejected, security instrument was tested in the case of \textit{Re New Bullas Trading Ltd.}\textsuperscript{98} In that case, the chargee was not a clearing bank and purported to take a fixed charge over book debts by giving the chargor only the freedom to collect the receivables but not to assign them, and upon collection of the proceeds, the chargee would take a floating charge over the proceeds. It is crucial that the chargee secures his rights as "fixed" before the company dissolves. The charge instrument was drafted this way in recognition of this fact. On the eve of winding up, if there were any receivables that could be realized by the liquidator, they would be subject to the fixed charge, and the chargee would rank ahead of preferential creditors. The Court of Appeal upheld the \textit{New Bullas} "split" charge as good and held that there could be a fixed charge over the unrealized book debts, and a subsequent floating charge over the realized proceeds. The Court of Appeal used a tree and fruit analogy to describe the unrealized book debts as a tree, and the realized proceeds as fruit separate from the tree, concluding that and thus, there could be two charges over two conceptually different assets.

The question of whether the charge over book debts could be split into two stages generated great academic controversy. Some prominent commentators fervently argued that book debts and proceeds are one continuing security interest,\textsuperscript{99} while others

\textsuperscript{97} It has been suggested that cultural perceptions of debt may affect the legal framework for credit and insolvency in a jurisdiction, and in the United Kingdom, the cultural perception of debt is not as liberal and forgiving as in the United States. See Nathalie Martin, \textit{The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation}, 28 B.C. Int'l & Comp. L. Rev. 1 (2005). Therefore, it may be argued that \textit{Brumark} and \textit{Spectrum} manifest the more conservative culture of the United Kingdom, and prominent judges have decided that borrowers and lenders cannot always structure their credit agreements in the novel ways they wish.

\textsuperscript{98} \textit{Re New Bullas Trading Ltd.}, [1994] 1 B.C.L.C. 36.

favored the split approach. However, some commentators criticized the Court of Appeal for supporting the split charge phenomenon while disallowing the fixed charge over the receivables. Because the chargor had the autonomy to collect the proceeds and to decide the destination of the proceeds, the chargee did not have enough control over the receivables to have a fixed charge. The issue of how much control a chargee needed to have over the asset to have a fixed charge resurfaced; it seemed that the Court of Appeal did not analyze whether the fixed charge over the book debt receivables should be regarded as fixed in law, but merely rubber-stamped the parties’ intentions. All in all, the issue of the definition of a fixed or floating charge became acute because of the priority issue, and there were fears that in interpreting the charge, the parties could have to drive a coach and horses through Parliament’s insolvency policy. The bundling of the definition and priority issues is arguably unnecessary if the United Kingdom adopted clearer conceptual delineations between the definition of a security interest, means of taking of a security interest, and priorities. There is now sufficient recognition in the United Kingdom that interpretive issues have to be resolved. In Brumark, Lord Millet authoritatively stated that categorizing the nature of the security interest was a matter of law, and thus affirming the law’s role to provide the legal framework in which the policy at insolvency would apply. The approach is affirmed in Spectrum, where it was stated that the categorization of security interests would depend on the “nature and substance of the

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100 Robert R. Pennington, *The Interchangeability of Fixed and Floating Charges*, 24 *Co. Law.* 60 (2003) (exploring the possibility of convertible charges, or a charge that is created first as a fixed charge and then becomes a floating charge); *see also* Berg, *supra* note 95, where it is suggested that distinguishing between a receivable interest and its proceeds is not conceptually an error.


104 *Id.*

arrangement” between the lender and borrower. Thus, the judiciary clearly recognized the need for what I would term “a legal fabrication of security interests in the United Kingdom.” The call to look beyond parties’ intentions to the “substance” of the arrangement is new, and seems to introduce a guiding principle to interpretation that may be based on the function of the financing arrangement. The Law Commission in its recent proposal did not expressly say that security interests should be defined in terms of a functional approach, but its recommendation as to what should be registered as a company charge includes most forms of transactions that were in substance a security. Hence, it could be argued that there is much support for adoption of a “substance” based approach in interpreting security interests by the United Kingdom.

B. Unbundling in the United States and the Functional Approach

In the United States, early case law that stunted free development of financing arrangements led to a movement to reconceptualize security arrangements and provide a total legal framework to address credit and security. This resulted in the construction of a comprehensive legal framework under Article 9 of the Uniform Commercial Code. Article 9 provides a functional definition of a security interest, so that any financing arrangement that provides a secured lending effect will be a security arrangement. Therefore, retention of title financing would be regarded as a security arrangement in the United States, though not in the United Kingdom.

Article 9 also unbundles the definition issue from the means of

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106 Id., § 32.
108 For example, the Law Commission, supra note 11, pt. 4 (recommending making sales of receivables registrable); see also id. ¶ 3.19-3.29 (recommending pledges which allowed possession of the asset to remain with the debtor). However, the Law Commission was silent on the issue of agency sales financing and specific purpose trusts although these transactions may have financing aspects. Title reservation was also expressly excluded from registration. See id. ¶ 1.60-66.
110 See U.C.C. § 9-102(1) (2005) defines security interest as “an interest in personal property or fixtures which secures payment or performance of an obligation.” Id.
taking security. The concepts relating to means of taking security are "attachment" and "perfection." Security has to be attached and perfected. Attachment refers to the point in time when the security interest becomes valid between the lender and borrower. Perfection is when the interest becomes effective against third parties. Security interests may be taken by possession, which serves both as attachment and perfection, or by filing a financing statement, which perfects a security interest attached by contractual agreement. Commercial developments in security with novel qualities, such as deposit accounts, have created developments in the concepts of attachment and perfection. Deposit accounts have to be taken by "control" over the asset, and "control" is elaborately defined in Article 9. U.C.C. § 9-104-107 (2005). Finally, the issue of priority is also unbundled as secured lenders generally have full priority except in specific cases such as with purchase money security. Purchase money security is money advanced in order to acquire an asset that is the subject of the security. It ranks ahead of other interests in that asset.\textsuperscript{111}

The approach in Article 9 of the Uniform Commercial Code (UCC) has been praised for attaining interpretive and conceptual clarity, as well as setting up a reliable system of registration which lenders can rely on when making lending decisions. This has led to the development of cheaper and more efficient provisions of credit, and less litigation.\textsuperscript{112} Article 9 provides three distinct conceptual elements in security law: the definition of security interest; the means of taking in the concepts of attachment and perfection; and priorities at insolvency. This avoids the bundling problems experienced in the United Kingdom.

However, there is more to Article 9 than meets the eye. Although conceptually unbundled, the three concepts are by no means easily conceptualized. First, although the definition of a security interest is functional, there is still a need to prescribe what


\textsuperscript{112} This is generally agreed to in A. Diamond, A Review of Security Interests in Property (H.M.S.O. 1989), a report submitted in the eighties to the U.K. government for reform of personal property security law, which was never adopted. See also Mark Lawson, The Reform of the Law Relating to Security Interests in Property, J. Bus. L., 1987, at 287(discussing the report).
financing arrangements may be accepted as having created security interests. As commercial needs evolve, the types of financing instruments change, and novel types of financing instruments have to be considered as to whether or not they created security interests. The characterization problem of security interests is inherent in both the United States and the United Kingdom.\(^\text{113}\)

Second, the means of taking security could change with the emergence of new assets and new methodologies of taking interests over assets. As novel types of security interests such as deposit accounts developed, the law had to provide for a new means of taking the asset. Control was developed as a means of taking an interest that would trump registration in respect to the same asset. Amendments to Article 9\(^\text{114}\) were made in order to allow security to be taken over deposit accounts, with the means of taking deposit accounts as security by "control."\(^\text{115}\) "Control" would trump registration in respect to deposit accounts, investment properties, and letter-of-credit rights.\(^\text{116}\) Therefore, priority determined by time of filing would be subverted where "control" is stipulated to be a stronger perfection mechanism. As such, it could be argued that priority by control is a form of bundling, as the priority issue is determined by the means of taking a security interest. Article 9's clarity is challenged by novel commercial developments that compel concepts to be bundled. However, Article 9 still achieves relative clarity compared to bundling in the United Kingdom, as "control" is very specifically defined in relation to each asset capable of perfection by control.\(^\text{117}\)

Furthermore, as political pressure for priority issues has been

\(^{113}\) In 1999, specific amendments were made to Article 9 to allow the creation of security interests to be created over letters of credit, health care insurance, leasehold interests, promissory notes, and other instruments, in spite of contractual restrictions. See U.C.C. § 9-406-409. See also Michael L Owen, Reforms of the law of Secured Transactions in Mexico and the US, 10 US-Mex. L.J. 99 (2002). See also McCormack, Rewriting the English Law of Personal Property Securities, supra note 49; see also McCormack, Personal Property Security Law Reform, supra note 15.


\(^{115}\) U.C.C. § 9-327. "Control" is defined in U.C.C. § 9-104.


mounted by different lobbying groups, carve-outs from full priority in secured lending have been provided in Article 9, and it has been hypothesized that the process of drafting the U.C.C. is too heavily influenced by political pressures. The apparent conceptual clarity of Article 9 is deceptive. The reality is that Article 9 has been modified over the years and the rules regarding attachment, perfection, and priorities have become rather complex. However, what is commendable is that Article 9 concepts are by and large not bundled; the type of security interest is not defined by the means of taking or insolvency priority. This arguably allows finer sophistications to be developed within each concept. Although the three concepts are evolving, the relative superiority in the clarity of Article 9 is still quite evident compared to the bundled approach in the United Kingdom.

That is not to say that importing Article 9 into the United Kingdom would largely resolve the interpretive issues brought about by bundling. Article 9 is a system of its own, and the United Kingdom has already evolved a system that commercial players how to navigate. In marrying the two systems, various problems may occur. The importation of Article 9 into U.K. law may cause the demise of the floating charge, which is cherished in the United Kingdom. The Law Commission has tried both to preserve the floating charge as while still introducing an Article 9 type registration system in its proposals, but some have argued that this is not quite possible. There are problems in streamlining the floating charge with Article 9 concepts such as attachment and perfection. The floating charge becomes fixed upon the floating class of assets at the point in time of crystallization. However,

118 Article 9 was amended in 1999 to provide for the subordination of perfected security interests by filing to lien creditors over goods, such as buyers or lessees of goods, or licensees of intangibles under certain conditions. See U.C.C. § 9-317-322.
120 See supra note 118 for discussion of Article 9 amendments.
121 Law Commission, supra note 11, ¶ 3.164.
122 See Law Commission, supra note 11, ¶ 3.158.
124 Re Yorkshire Woolcombers Ass'n Ltd., (1903) 2 Ch. 284.
crystallization is an alien notion to both attachment and perfection. In order to reconcile the two systems, it may be that crystallization has to be regarded as an event that should be registered again to be perfected, but that would be very cumbersome for lenders. Or should the idea of crystallization be done away with so that the charge is essentially regarded as a fixed interest over a class of assets which may be revolving? If this change in characterization occurs, then one advantage to the uncrystallized floating charge, which is the possibility of execution creditors taking from the class of assets before crystallization to satisfy judgment debts, would be lost; the charge would be characterized as a "fixed" one. Importing Article 9 would also mean that reconciliation with the existing company’s charges register has to be made and a new registry dealing with personal property security financing statements would have to be set up. This may create costs in terms of public regulation. The Law Commission suggested the implementation of an Article 9 type registration system to replace the existing company charges register, and then further review as to its more general extension may be undertaken in the future. However, the Law Commission realized that significant costs are associated with reconciling all the existing registers of security interests, including Land Registers, and registers of security interests taken over ships, aircraft and intellectual property. Taking a step back from the technical questions of how to import Article 9 into the United Kingdom, one should not conclude too quickly that Article 9 is the answer for the

125 This view could be supported by Sarah Worthington’s “defeasible charge theory” of the floating charge, where the floating charge is regarded as a fixed charge with a license to deal. The charge is defeasible when the charger deals with the assets within the ambit of the license. See generally Sarah Worthington, Floating Charges—An Alternative Theory, 53 CAMBRIDGE L.J. 81 (1994). However, Professor Worthington seems to have adopted new views of the floating charge, as her comments against the split charges phenomenon in the Bullas Trading case seem to suggest that there is a clear difference between the fixed charge and floating charge, and the floating charge is premised upon the ability of the chargor to remove assets from the ambit of the charge. Worthington, supra note 88.

126 However, this position is recommended by the Law Commission. Law Commission, supra note 11, ¶ 3.201-204, at 79-80.


United Kingdom's weak legal fabrication of security interests. The methodology in Article 9, that is, the unbundled approach, may be a step that the United Kingdom should follow first in order to achieve conceptual clarity. Since the introduction of preferential creditors into the priorities system in insolvency, there has been a need to firm up the legal interpretation of security interests. The policy, which is framed in the existing language, could then be effectively enforced. This need to firm up the legal interpretation of security interests was not given full articulation until recently in Re Brumark.\textsuperscript{129} Thus, courts are only beginning to follow the guidance of the House of Lords in the direction of legal interpretation.\textsuperscript{130} The new landscape of legal interpretation may give rise to future chasms between what commercial lenders have defined as security interests and the courts' language of interpretation. The need for clear legal fabrication of security interests should quickly be met in the interests of commercial expediency.

\hspace{1cm} \textbf{C. Proposal for an Unbundled Approach}

In this paper, I recommend that the conceptually unbundled approach taken in the United States should be followed in the United Kingdom's progress towards legal fabrication of security interests. The unbundled approach consists of three main conceptual pillars: (1) the definition of a security interest, (2) the means of taking such security to be valid against the borrower and third parties, and (3) the priorities for secured lenders in insolvency. Although the three concepts are not themselves simple concepts capable of easy definition, the unbundling approach should treat them as three distinct concepts, and then the three concepts can each be fleshed out in a more sophisticated fashion, and their overlaps can be drawn out.

In terms of the definition of security interest, the United Kingdom has to choose between the formal approach and the substance approach. The substantive approach, which may be based on the functional approach taken in the United States, would provide characterization of a security transaction based on the effect of the transaction. If the transaction has the effect of

\textsuperscript{129} Agnew, [2001] A.C. 710.

\textsuperscript{130} In Re Spectrum, [2005] 3 WLR 58.
providing financing, the transaction should be regarded as a security arrangement. The formal approach would be based upon construction of parties' intention in the contract, and if parties intended to provide financing, then a security arrangement arises. However, if the arrangement provides for transfers of legal title or retention of legal title, then it is a transfer and not a security arrangement. The formal approach would retain much of what is familiar to the legal community in the United Kingdom, but that may be undesirable for legal fabrication of security interests because it may undermine the conceptual unity of security interests. However, the substance approach may raise issues as to whether trusts and other quasi-security would become defined as security interests as well.\textsuperscript{131} There would also be a need to consider the relationship between the parties in the financing arrangement, and if custodianship and fiduciary duties are involved, whether these transactions should be regarded as security transactions. The Law Commission seems to prefer the substantive approach, but it does not present a comprehensive legal fabrication of security interests in the United Kingdom.\textsuperscript{132}

If novel means of taking assets may arise, this paper posits that the means of taking should not daunt the legislator. Rather, a general rule is that any legal means of taking could confer a right \textit{in rem} in the asset in question, and there should not be restrictions on how an asset may be taken as security. The key issue lies in the strength of the security as a result of the parties' chosen means of taking. The original Article 9 arguably did not provide for the concept of security strength. Rather, all security was ranked according to the time the financing statement was filed, and hence, all security had an equal status regardless of how it was created. But as discussed, Article 9 has over the years provided carve-outs from the full priority status of registered security.

It now provides that control over deposit accounts may entail a stronger security than registration, so that a registered creditor without control may lose priority to a subsequently registered creditor with control. The carve-out from full priority also extends to some lien creditors over goods in Articles 9-317 through 9-


\textsuperscript{132} See Law Commission, supra note 11, § 1.60-66, at 18-20.
Thus, the more general concept of security strength should be introduced in legal fabrication of security interests, even under Article 9. Although the Law Commission wishes to follow the American approach of ranking by time of filing, it also imports the idea that control is superior to registration, and even distinguishes between positive and negative control, recommending that negative control be regarded as stronger than positive control. Thus, it is submitted that a comprehensive overview of security strength should be undertaken for the purposes of ranking, and that time of filing should determine ranking only amongst security interests with the same degree of strength.

The Law Commission faced the dilemma that if it recommended that ranking should depend on time of filing, then floating charges filed first would have priority over subsequent fixed charges. However, the Enterprise Act of 2002 still provides for preferential creditors to take priority over floating charges and not fixed charges. The Law Commission recommends that, as a matter of practice, it will be likely that lenders will demand that borrowers seek the consent of floating charge holders to defer priority to the subsequent fixed charge. There would be no conundrums in applying the priority policy in the Enterprise Act. If an odd situation like that described above occurred, the Law Commission recommends that the floating charge holder and the subsequent fixed charge holder should both have priority over the preferential creditor. This outcome contradicts the wording of the Enterprise Act and means that if a borrower subjected property already charged to a floating charge holder to another fixed charge, the affected floating charge holder’s position would actually improve because it would go ahead of the preferential creditor. If the borrowers were scrupulous and did not charge the property again, the floating charge holder would be in the worse position of being subordinated to the preferential creditor. This odd situation would be averted if clearer fabrication is provided regarding the strengths of different security interests. The Law Commission’s awkward recommendation shows that there is a

135 Insolvency Act, 1986, c. 40, § 59 (Eng.).
need to reconcile the idea of security strength with priorities.

In determining strength of security, it could be argued that the strongest takings of security would be: transfers of legal title with reservation or equity of redemption, or possession of negotiable instruments or other chattel with an undisputed right to dispose. Weaker forms of security would include possession without a right to resell (a lien), possession with limited rights of disposal and account, and contractual charges with various terms that may control or restrict the chargor’s dealings in the asset in question. Therefore, a strong security results from a party’s decision to transfer legal title with an equity of redemption. If parties choose to hand over possession of a bill of lading, that is a strong security. However, if parties instead assign chattel paper subject to contractual agreement that there is no right of transfer without consent, that is a weaker form of security, just as parties who choose to take a contractual right over possible enforcement against an asset that remains in the debtor’s possession is a weaker security. The law should also consider how many degrees of strengths and weaknesses it wishes to prescribe based on different degrees of possessory rights, contractual rights, and ownership rights. An asset could be taken as security in many different ways. While the way it is taken should not be restricted in law, the means of taking should be fabricated in law to interpret the effect of such taking, that is, whether a stronger or weaker security has been created. Furthermore, in determining the means of taking, the law should provide for the validity of the security inter partes as well as against third parties. This article suggests that validity against third parties should be achieved in a manner that is as streamlined as possible with the taking of security between creditor and debtor. This means that perfection of a security interest should not involve too many cumbersome and extraneous steps after attachment, although certain types of attachment automatically suffice as perfection, such as possession and control. The Article 9 approach of registration is the simplest method of perfection, as it requires only one extra step of filing after parties have concluded their transactions.

The United Kingdom’s approach to perfection is very compartmentalized, and different transactions require different
methods of perfection.\textsuperscript{137} Where assignments or charges over debts are concerned, perfection is very cumbersome because notice to the account debtor must be given. This is the oft-criticized rule in \textit{Dearle v. Hall}.	extsuperscript{138} Thus, in the legal fabrication of security interests in the United Kingdom, reform is necessary in regards to how parties who have concluded a security transaction may perfect that security interest to the world. The means of perfection should be kept as simple as possible in the interests of commercial expediency, without compromising the effectiveness of the perfection which is meant to benefit third parties. In this light, a registration system centrally run and maintained, like that established under Article 9, would be superior.\textsuperscript{139}

Finally, priorities should conceptually be a separate issue from definition and means of taking, although they would be affected by different security strengths. This is an area where there could be conceptual interdependence between the means of taking a security interest and the priority of a security interest. A policy choice should be made in order to rank strong forms of security over weaker forms of security; between equally strong security interests, the first in time of filing should prevail. The entry of preferential creditors would also have to be decided. If legal fabrication is to be carried out successfully, the legal fabrication of priorities in the Enterprise Act of 2002 would have to be aligned with the language in legal fabrication of security interests.

However, it may be argued that preferring strong security would result in lenders imposing harsher terms of credit in lieu of strong security interests, or refusing to lend unless they could obtain strong security. That would be undesirable for commerce. On the other hand, lenders are not likely to kill the goose that lays golden eggs. Lenders have an interest in preserving the going concern of their debtors. This is to be manifested in the existence of laws upholding composition agreements and voluntary arrangements by companies. Lenders and borrowers may be able to work out security arrangements that may be a combination of strong and weak security interests in order to hedge the lender's

\textsuperscript{137} See McCormack, \textit{supra} note 49.

\textsuperscript{138} Dearle \textit{v. Hall}, 3 Russ. 1 (1828) (finding that priority between assignees of book debts is determined by who first gave notice to the account debtor).

\textsuperscript{139} See Law Commission, \textit{supra} note 11, ¶ 2.18, 2.20, & 2.26, at 28-9.
position. Giving priority according to strength does not necessarily result in lenders taking harsh and defensive positions and strangling credit. Defining priority according to strength may also be necessary as new commercial developments provide myriad types of interests that could be taken as security, and not all security interests are equal. Evasion of the issue of classifying stronger and weaker security does not prevent commercial innovations from being made or lenders from trying to improve their positions through clever drafting. Thus, the original straightforward priority under Article 9, as granted according to time of filing, may have to be modified to accommodate new needs. This is already manifested in the amendments to Article 9, such as the preference for control over registration where security over deposit accounts is concerned. The figure below illustrates the legal fabrication of security interests proposed in this article.

IV. Options for the United Kingdom in Legal Fabrication

How may the legal fabrication of security interests, as described in Part III.C be achieved in the United Kingdom? The Law Commission acknowledged in a recent report that a comprehensive review is forthcoming and was not the task of its recent report.140 The definition of a security interest involves a

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140 Law Commission, supra note 11, ¶ 1.70, at 21.
policy decision of choosing between the substance or form approach, and whether fiduciary duties in the transaction should make a difference to the definition. As such, policy choice may best be undertaken by the legislature. The 1989 Diamond Report, which was never implemented, recommended a substantively based functional approach to definition. The Law Commission Report arguably adopts that approach as well.

As to legal fabrication of the means of taking security interests, there should also be codification in order to provide for the concept of security strength and the factors that determine relative strengths and weaknesses of a security. This form of reconceptualization would be very difficult to achieve via the incremental interpretation carried out by judges in individual cases. The realignment of priorities in accordance with the legal fabrication of security interests should also follow as a legislative measure. It remains to be seen if the government would take up the Law Commission’s recent report to the legislative process. The likeliest resistance to the Law Commission’s recommendations comes from the government itself, as it has to shoulder the cost of running an expanded filing registry. If private law developed and evolved to eventually clarify the interpretation of security interests, then the interpretation of the purposes served by private law would be the same as under codification and there would be no need to codify now. Furthermore, there are constraints in codification as well due to revisions that may be needed in the future with changing commercial needs. As interpretation by courts could only be carried out when the case arises before them, the legal interpretation of security interests could only be developed with significant private costs in litigation. However, such private costs may be justified. If this area of law matters most to the private litigants themselves, then it may be appropriate for the litigants to fund its development, rather than taxpayers. However, the cost to the taxpayer may be minimal and may be a benefit that outweighs the cost of private litigation. In a perverse

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141 Diamond, supra note 112.
142 Supra note 108.
143 See DAWN OLIVER, COMMON VALUES AND THE PUBLIC DIVIDE (1999). Dawn Oliver argues there may be very little difference between the common values and objectives served by public versus private law.
way, private litigation costs would continue to fund commercial lawyers who may attempt to keep the status quo at its best for their clients. In sum, legislation would provide a necessary and long overdue comprehensive reconceptualization, but the question of who should finance this reform remains a thorny question in the United Kingdom.

A. Courts

Commercial lawyers may still welcome maintaining the status quo and allowing the courts to develop the interpretive issues in security law because the courts have recognized the crucial issue: interpretation of security interests as a matter of law. How that interpretation would be carried out is not so predictable, since there is mention that "substance" of the arrangement would be reviewed. Thus, the courts may re-categorize security instruments in a way unforeseen by parties.

Professor Goode argues that it is not ideal to allow the judiciary to continue as the primary agent in developing the law of security. Here, the development of the law could be unnecessarily complex and inelegant compared to the relative simplicity of Article 9 of the UCC. Furthermore, judicial interpretations would be heavily based on fact and would not be very useful for posterity. Judges are also constrained in the number of general statements they may make. If the judiciary re-characterizes transactions that have been relied on for a long time, without prospective overruling, this would disturb thousands of commercial transactions that have relied on what best seemed to be thought of as law at that point of contracting. An ex post system of discovering the law may be very costly for commercial players. Further, it is also argued by Professor Komesar that the judiciary is perhaps the least appropriate institution for the resolution of large-scale problems that affect a substantial amount

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144 See McCormack, Rewriting the English Law of Personal Property Securities, supra note 49. McCormack also refers to the inertia of the legal profession in welcoming any change to personal property security laws in the United Kingdom.

145 The U.K. courts are highly reluctant to adopt prospective overruling. See Spectrum Plus, 2005 WL 1505126 ¶ 4-43 (stating categorically that prospective overruling is not part of U.K. practice and there would be many constitutional and principled arguments to overcome before adopting the practice).

146 GOODE, supra note 14, at 59-80.
of people. This is because increased numbers of people interested in a legal issue would force legal rules propounded by the judiciary to become more complex and qualified, and that would generate more litigation in itself, becoming a vicious cycle. The judiciary's resources are too limited to cope with this phenomenon and the judiciary may arguably start to rely on the market or legislature to supply the long-term solutions, and abdicate from taking an active part in resolving the issue.\textsuperscript{147} However, one must bear in mind that the English judiciary has developed a phenomenal amount of popularly affirmed commercial law since the days of Lord Mansfield.\textsuperscript{148} But Lord Mansfield and his successors had a different role. They brought many commercial practices into the law and clarified these practices. These days, the judiciary would have to resolve particular legal issues before them while bearing in mind superior policies such as insolvency priorities. The choice of the institution to undertake primary responsibility for developing security law in the United Kingdom would not be an easy one, but the choice affects the substantive law that would be developed in the future, and according to Professor Komesar, the institution matters.\textsuperscript{149}

\textbf{B. Market Self-Regulation?}

Market forces could provide appropriate solutions if the forces of competition work to allow an optimal solution. This is assuming that there are no market failures or externalities involved in the process. If the economic assumption of the rational man holds true, then each lender must look out for himself and maximize his own interest, and each lender, under the current policy, would choose to take the best security as far as possible.\textsuperscript{150}

\textsuperscript{147} Neil Komesar, Law's Limits 35 (Cambridge Univ. Press 2001).

\textsuperscript{148} Lord Mansfield was a prominent commercial judge in the nineteenth century. A brief discussion of the development of English commercial law may be found in Roy M. Goode, Commercial Law 33-35 (1982).

\textsuperscript{149} Komesar, supra note 147, 198.

\textsuperscript{150} But see, Ronald J. Mann, Explaining the Pattern of Secured Credit, 110 Harv. L. Rev. 626 (1997) (arguing that some lenders choose to go unsecured for other reasons and thus, it is not necessary to assume that lenders all want the best security). However, for simplicity, the trend that lenders want best security, all other things being equal, is assumed here to demonstrate the difficulty of relying on the market to provide the solution to interpretation of security interests.
This is already the default scenario in many of the cases where lenders have structured ingenious fixed charges over book debts. The market tends to protect preferential creditors and cannot be relied on to provide its own solution. Moreover, the issue at hand is a legal issue in fabrication of security interests. The provision of a legal framework is necessary and should not be delegated to the market.

C. Academic Codification?

Academics may contribute to the legal fabrication of security interests in the United Kingdom. By "academic codification" there could be either an emphasis on "academic" or an emphasis on "codification." If one emphasizes "codification," it could mean that the process of legal scholarship is used to produce a code on an area of law sought to be clarified and codified. Such a work of codification could then become adopted by the legislature to become law. Chalmers' codifications of the Sale of Goods Act of 1894 and the Marine Insurance Act of 1907 are examples of such codification in the United Kingdom, as well as statutory reform recommended by the Law Commission. A prominent example in the United States would be restatements of various areas of the law and the production of the U.C.C. by the American Law Institute. Codification could include anything from all-inclusive reviews and complete restatements, to smaller scale efforts in

151 See generally Re New Bullas Trading, (1994) 1 B.C.L.C. 485 (Eng.).

152 In a smaller community, the difference between a pragmatic solution that markets provide, and a solution provided under law, may be of little practical difference. However, law as an autopoeitic system has been argued by several prominent commentators, and this paper affirms that the legal framework is a separate system, though it has symbiotic ties with the economic relations and reality that it frames. See Gunther Teubner et al., After Legal Instrumentalism: Strategic Models of Post-Regulatory Law, in DILEMMAS OF LAW IN THE WELFARE STATE 299 (Gunther Teubner ed., 1986); see also Julia Black, Constitutionaising Self-Regulation, 59 MOD. L. REv. 24 (1996).

153 For example, the Law Reform (Frustrated Contracts Act) 1943 and the Family Law Reform Act 1987.

154 In the United States, the American Law Institute is the foremost example of such codification efforts through academic discourse and work under the Institute. But the historical reasons giving rise to the Institute are unique in the context of complex and messy state laws and the preservation of legal elitism in the United States. See G. Edward White, The American Law Institute and the Triumph of Modernist Jurisprudence, 15 LAW & HIST. REv. 1 (1997).
tidying up and putting together in a single text all the issues relating to a small area such as unfair contract terms. If the United Kingdom is hesitant in passing legislation for the legal fabrication of security interests, then even if legal scholarship produces a code, it would take many obstacles to be overcome before the code becomes law.

Another possible interpretation of "academic codification" is the emphasis on "academic," namely the work of systematically organizing issues and concepts in an area of law in treatises. Treatises have been indispensable as a means of structured study in legal education, and the common law has probably survived largely because of the complementary efforts of treatise writing. However, these efforts need not produce a legal code on the issue area concerned.

The concern with the codification of security laws into statutory form is that such codification would have to grapple with the question of whether or not to provide a notice filing system administered by the state. The notice filing system entails great cost because reconciling with the existing company charges register would have to occur as well as the set up of a new administrative office and infrastructure. Lawyers would have to familiarize themselves with a new system of security interest creation and work process. These reasons may account for the United Kingdom's resistance as well as the legal community's reluctance to champion codification of security laws. Furthermore, it may be uncertain whether codification would provide the most desirable solution to resolving interpretive issues in security law. Many would argue that the code is a straitjacket and many revisions may be needed in the future for

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157 Political championing and embracing by the community are essential factors to a code's successful launch. See John W. Head, Codes, Cultures, Chaos, and Champions—Common Features of Codification Experiences in China, Europe, and North America, 13 DUKE J. COMP. & INT'L L. 1 (2003); James J. Brudney, Mediation and Some Lessons from the Uniform State Law Experience, 13 OHIO ST. J. DISP. RESOL. 795 (1998) (discussing the codification of mediation laws).
adapting to changing times.\textsuperscript{158}

Codification itself is also a process that may select and jettison legal issues so that they become bureaucratized. The code could become so deceptively self-contained that it could fail to admit other related concerns or fail to connect with other integral areas of law.\textsuperscript{159} It has also been argued that codification often results in the selection of certain underlying assumptions of an issue area, and that selection results in the marginalization of equally contending assumptions of the same area that could inform future legal progress.\textsuperscript{160}

In the absence of comprehensive reform in the United Kingdom, it should be acknowledged that legal progress could at least be derived from a more systematic fabrication of security interests.\textsuperscript{161} The common law is capable of a systematic ordering of legal issues and principles, if supported by both treatises and issue-specific statutes.\textsuperscript{162} If all things remain unchanged, academics should take on the role of facilitating the legal fabrication of security interests, by providing an unbundled approach to discussing security interests. Academics are also at liberty to suggest how the law may be reformed. Treatise organization affects judicial perspectives, and if the judiciary is open to the legal fabrication provided in leading treatises, the common law could still provide a sound legal fabrication of security interests. Some leading treatises in the United Kingdom on secured credit are already structured in an unbundled way, but they also reflect the reality of the formal and transaction-specific approach taken in the courts.\textsuperscript{163} Perhaps a new approach could be taken to rigorously unbundle concepts in security law so as to

\begin{flushleft}
\textsuperscript{159} \textit{Id.}
\textsuperscript{160} \textit{Id.}
\textsuperscript{161} Omar, \textit{supra} note 158.
\textsuperscript{163} See generally Goode, \textit{supra} note 36 (devoting chapters to definitions and means of taking, fabricated in the language of "attachment and perfection," but specific chapters are devoted to the compartments of fixed and floating charges, security over receivables and so on); see also Wood, \textit{supra} note 37 (organizing text more in terms of the specific financing arrangement concerned than by unifying concepts).
\end{flushleft}
encourage the development of legal fabrication in more conceptual terms. However, the question remains as to whether treatise exposition, informed by precedent in the common law tradition, is sufficient to develop a body of security law for current commercial needs. A variety of efficient responses in law may be needed to match rapidly changing commercial needs. But a cogent treatise coupled with a revolutionary case, much like the leading case in tort law, Donoghue v. Stevenson,\(^{164}\) could provide the much needed legal infrastructure for security law in a short number of years, and that could be the same length of time needed for study, consultation, and putting into motion the legislative process for a codified solution.

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\(^{164}\) Donoghue v. Stevenson, [1932] A.C. 562 (H.L.C.) (appeal taken from Scot.) (U.K.). Donoghue is indisputably the leading case that started the growth of English tort law. Before Donoghue, personal injuries outside a contractual relationship could hardly be claimed in court. This case is regarded as the genesis of tort law in the United Kingdom, and thus it is possible for private law to provide systems of law to resolve social or commercial problems without legislation.