FIXED AND FLOATING CHARGES

THE Privy Council decision in *Agnew* v. *Inland Revenue Commissioner* [2001] B.C.C. 252 (on appeal from the New Zealand Court of Appeal in *Re Brumark Investments Ltd.*) decides that where a charge over the uncollected book debts of a company leaves the company free to collect and then to use the proceeds for its own benefit in the ordinary course of business, the charge is inevitably a floating charge and not a fixed charge, whatever the debenture might say. The court's reason for this, in short, was that it makes no commercial sense to separate a book debt from its proceeds and so, if the company can use the proceeds at will, then the charge on the debt itself must be a floating charge.

The decision is the last in a long line of cases endeavouring to distinguish between fixed and floating charges. The distinction is important in common law countries which have the universal fixed and floating charge because of the weaknesses of floating charges compared to fixed charges. The most important of these weaknesses are, typically and subject to detailed local variations:

(1) A floating charge ranks after certain taxes and employee wages and benefits up to limits;
(2) A floating charge created by an insolvent company is liable to be set aside except, essentially, to the extent of new money lent at the time of the charge (a particular problem for group guarantees where the guaranteeing subsidiary does not receive new money);
(3) A floating charge has weak priority against execution creditors, landlords' distress, set-offs, possessory liens and the like; and
(4) In the UK, there is no adequate protection for floating charge assets on an administration and the administrator can subordinate the floating charge to new money to finance the administration under section 19(5) of the Insolvency Act 1986. Presently the holder of virtually universal security including a floater can block the administration, but the Government has signalled that it intends to remove this veto.

The battle by the banks to convert their floating charges over book debts into fixed charges really began in earnest in the 1970s when the enlargement of tax and employee claims seriously eroded realisations from an insolvent company's book debts. The pendulum swung back and forth according to the degree of blocking on the company's account until the ingenious debenture in

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the case of *In re Bullas* [1994] 1 B.C.L.C. 449. Here, the draftsman's separation of the uncollected book debts (fixed charge) and the proceeds of the book debts (floating charge) was upheld by the Court of Appeal. It is this decision which *Agnew* has struck down on the basis that book debts are essentially their proceeds and therefore if the company can deal with the proceeds freely, *e.g.* by using them to pay its trade liabilities, then the charge on the collected book debts must be a floating charge. The result is that the Crown and the crew come first, the various devices are ruled out of order and that is the end of that.

Or is it? One problem arises in relation to assignments of large contracts in major financings, *e.g.*:

(1) Project finance where typically the banks have a charge over the construction contract, the concession, the supply contract and the off-take contract for, say, the supply of electricity;
(2) Aircraft and ship finance where the financier has an assignment over the lease or charterparty; and
(3) Securitisations where the bondholders have charges over the receivables, the sale contract and the administration contract.

These arrangements often involve large amounts and the routine and central role of the revenue-producing contracts is of old lineage, *e.g.* the ship charter.

Generally the proceeds from these contracts are paid into a charged bank account and there is a "waterfall" clause whereby the proceeds from the main contract can be used by the chargor first for payment of operating costs, then debt service and then sometimes payments into reserve accounts, with the surplus being at the free disposal of the company. The effect of this is that, although there is a block of sorts, the company can commonly use proceeds of the main contract or lease to pay trade and operating costs until a default. Obviously the company must be free to do this.

If therefore *Agnew* holds that, wherever the company has a right to use the proceeds of the contract once in the bank account for defraying its ordinary liabilities, the charge is inevitably a floating charge, then this would be an odd result. The effect would be that English law does not allow a specific fixed assignment by way of security of a large revenue-producing contract in these circumstances; the floating charge is floating over the contract itself with all the attendant disadvantages of floating charges which should not sensibly apply to this instance.

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Agnew does not enlarge on this type of situation: it is true that the decision applies to "book debts", but book debts are contractual. Therefore financial markets may still be back to the making of fine and uncertain distinctions about the degree of bank account blocking which is enough to prevent a charge from being a floating charge.

It would perhaps have been possible to have it both ways, *i.e.* to preserve the Crown and crew priority for book debts and also to maintain the specific charge, if it were admitted that the right to deal is not the only badge of the floater—there is another badge, *i.e.* it is a charge over a generic class of assets which are not specifically and individually identified. But reintroducing the doctrine of specificity back into the law of security interests is unattractive.

The irony is that the Crown preference is about to go and that *Agnew* is now irrelevant in New Zealand, which has overhauled its personal property security on the lines of the US and most Canadian provinces. England should consider doing the same, but even these personal property security statutes need a radical re-think.

PHILIP R. WOOD

SHAMS, PRETENCES, SUBTERFUGES AND DEVICES

THE statutory security of tenure conferred upon the tenants of private residential property has long been (to mix two metaphors) a fertile battle ground, with landlords and their legal advisers showing great ingenuity in devising agreements designed to circumvent the provisions of the legislation. Most famously, of course, there was the loophole of disguising the lease as a mere licence to occupy, which was effectively closed off by the House of Lords in *Street* v. *Mountford* [1985] A.C. 809. It is perhaps surprising that although security of tenure was first introduced as long ago as 1920, landlords are still able to come up with new devices in the attempt to ensure that they can regain possession of their property whenever they wish. One such device was the recent subject of consideration by the Court of Appeal in *Bankway Properties Ltd.* v. *Pensfold-Dunsford* [2001] 1 W.L.R. 1369.

The plan was disconcertingly simple. The original landlord (a company by the name of Artesian Competitor plc) granted to the appellants, Mr. Pensfold-Dunsford and Mr. Leech, what was expressly stated to be an assured tenancy made pursuant to the

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