FIXED AND FLOATING CHARGES OVER BOOK DEBTS: A POST MORTEM ON THE DEBATE

This article examines the main issues in the long-standing controversy regarding the distinction between fixed charges and floating charges over book debts, and analyses them in the light of the latest case law developments that have settled the issue in England.

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I. Background to the debate

1 Much of the discussion about the distinction between fixed and floating charges over book debts has taken place in the context of the insolvency of a company. In a receivership or a winding up, where the assets of the company are insufficient to satisfy the creditors, preferential debts have priority over the claims of a holder of a floating charge.[1] The

1 Section 328(5) of the Companies Act (Cap 50, 1994 Rev Ed) which deals with the priorities applicable in the winding up of a company, provides as follows:

> So far as the assets of the company available for payment of general creditors are insufficient to meet any preferential debts specified in subsection (1) (*a*), (*b*), (*c*), (*e*) and (*f*) and any amount payable in priority by virtue of subsection (4), those debts shall have priority over the claims of the holders of debentures under any floating charge created by the company (which charge, as created, was a floating charge), and shall be paid accordingly out of any property comprised in or subject to that charge.

Section 226 of the Companies Act provides:

> (1) Where a receiver is appointed on behalf of the holders of any debentures of a company secured by a floating charge or possession is taken by or on behalf of debenture holders of any property comprised in or subject to a floating charge, then, if the company is not at the time in the course of being wound up, debts which in every winding up are preferential debts and are due by way of wages, salary, retrenchment benefit or ex gratia payment, vacation leave or superannuation or provident fund payments and any amount which in a winding up is payable in pursuance of section 328 (4) or (6) shall be paid out of any assets coming to the hands of the receiver or other person taking possession in priority to any claim for principal or interest in respect of the debentures and shall be paid in the same order of priority as is prescribed by that section in respect of those debts and amounts.
>
> (1A) In subsection (1), "floating charge" means a charge which, as created, was a floating charge.

There are equivalent provisions in England are s 175 and s 40 of the Insolvency Act 1986 (c 45).

creation of a fixed charge therefore improves a financier's position *vis-à-vis* preferential creditors. Although the classic disadvantage of a fixed charge has been that the chargor would be prevented from dealing with the charged asset, this did not seem to present a real obstacle in the case of book debts, as there was generally no need for the chargor to deal with these whilst they were still uncollected. This led to the growth of arrangements whereby debenture holders would obtain a fixed charge over all the present and future book debts of a company, and at the same time made the agreement acceptable to the company by allowing the company to deal with the proceeds of the books debts in the ordinary course of business after the debts were collected. Whether such arrangements succeed in creating a fixed charge, or whether the charge should instead be categorised as a floating charge has been the subject of great academic and judicial controversy in the UK and also countries like New Zealand. The question is also an important one in Singapore, although it has not yet arisen directly for decision in the Singapore courts.

2 The House of Lords recently ruled on this issue in *In re Spectrum Plus Ltd*,[2] and confirmed the Privy Council's views in *Agnew v Commissioner of Inland Revenue*.[3] Although the dust has yet to settle, it is likely that the House of Lords decision will lay the controversy to rest in England. It is therefore an opportune time to look back on the debate to identify and analyse the main issues that have arisen, and discuss how these have been resolved. Although most of the cases involved in the debate concerned book debts, the debate and its resolution also have wider significance for the distinction between fixed and floating charges generally, regardless of the type of asset subject to the charge. This article will adopt an issue-based approach to examine the distinction between fixed and floating charges generally, and then focus on fixed and floating charges over book debts in particular. To avoid becoming overly embroiled in the baggage of the past, the article will draw primarily from four cases which together illustrate well the problems and solutions that have surfaced: *Spectrum Plus, Agnew, Siebe Gorman & Co Ltd v Barclays Bank Ltd*[4] and *Re New Bullas Trading Ltd*.[5] Just as *Agnew* and *Spectrum Plus* represent the last word on the matter in England, *Siebe Gorman* and *New Bullas* are equally significant in that they are the catalysts which

2 [2005] 3 WLR 58 ("*Spectrum Plus*").
3 [2001] 2 AC 710 ("*Agnew*"). This was a case which was heard on appeal from the Court of Appeal of New Zealand.
4 [1979] 2 Lloyd's Rep 142 ("*Siebe Gorman*").
5 [1994] 1 BCLC 485 ("*New Bullas*").

started and fuelled the debate. It will be suggested that the position taken in *Spectrum Plus*, though likely to be unpopular amongst commercial parties, is the right one and should also be the law in Singapore.

II. Distinction between fixed and floating charges generally

A. Test of floating charge: Freedom to deal with charged asset[6]

3 After the House of Lords decision in *Spectrum Plus*, it is clear that in England, the one essential characteristic that distinguishes a floating charge from a fixed one is that in a floating charge:[7]

> [T]he asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime the chargor is left free to use the charged asset and to remove it from the security.

4 This is not a new test. It corresponds to the third characteristic propounded by Romer LJ in his classical description of a floating charge in the Court of Appeal in *In re Yorkshire Woolcombers Association, Limited* where he stated:[8]

> … I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some further 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.

5 In *Spectrum Plus*, the House of Lords agreed with Lord Millett's view in the Privy Council decision of *Agnew* where he pointed out that Romer LJ's first two characteristics, although typical of a floating charge,

6 See W J Gough, *Company Charges* (Butterworths, 2nd Ed, 1996) ch 5; Roy Goode, *Legal Problems of Credit and Security* (Sweet & Maxwell, 3rd Ed, 2003) ch 4; Sarah Worthington, *Proprietary Interests in Commercial Transactions* (Clarendon Press, 1996) ch 4; *Walter Woon on Company Law* (Tan Cheng Han gen ed) (Sweet & Maxwell Asia, 3rd Ed, 2005) ch 13.

7 *Supra* n 2, at [111].

8 [1903] 2 Ch 284 at 295. This passage has been quoted and approved by the Singapore courts in various cases, for instance, by the Court of Appeal in *Chase Manhattan Bank NA v Wong Tui Sun* [1993] 1 SLR 1 and *Dresdner Bank AG v Ho Mun-Tuke Don* [1993] 1 SLR 114.

were not distinctive of it, and were not necessarily inconsistent with a fixed charge, and that it was the third characteristic that was important. The House of Lords also expressed their view that if a security had Romer LJ's third characteristic it would qualify as a floating charge, and cannot be a fixed charge, whatever its other characteristics may be.[9] That the House of Lords in *Spectrum Plus* identified just one of Romer LJ's three characteristics as being essential is not inconsistent with the views of the learned judge, as he had qualified his statement as follows:[10]

> I certainly do not intend to attempt to give an exact definition of the term "floating charge," nor am I prepared to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics …

6 The test propounded by the House of Lords in *Spectrum Plus* is also consistent with the view taken by the House of Lords slightly over 100 years ago in *Illingworth v Houldsworth*, where Lord Macnaghten said:[11]

> A specific charge … is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.

7 Although the terminology was different, the essence of the quotation from the earlier House of Lords case is the same as in *Spectrum Plus*. The ambulatory or shifting nature of the floating charge referred to by Lord MacNaghten in *Illingworth v Houldsworth* is a reflection of the chargor's freedom to deal with the asset and remove it from the security, as mentioned in *Spectrum Plus*. And in both cases, there is also reference to the future event or act that will end the chargor's freedom to deal with the asset.

8 These cases are just a few early examples of the many past decisions on company charges which have identified freedom to deal with the charged assets as an important element in a floating charge. It might therefore seem at first glance as if the law has ended up where it started, at

9 *Supra* n 2, at [106]–[107].
10 *Supra* n 8, at 295.
11 [1904] AC 355 at 358. This case was an appeal from the Court of Appeal's decision in *In re Yorkshire Woolcombers Association, Limited*, *supra* n 8.

least as far as the general distinction between fixed and floating charges is concerned. But there are important differences. Leaving aside the issues relating specifically to book debts, which will be discussed later, *Spectrum Plus* has advanced the general law in at least two ways.

9 First, the identification of the one essential characteristic of a floating charge is significant. It indicates authoritatively the hierarchy amongst the three characteristics mentioned by Romer LJ: The first two are dispensable; the third is crucial and exclusive to a floating charge. This adds a new twist to the old propositions. The third characteristic might have been universally acknowledged as being typical of a floating charge in the past. But *Spectrum Plus* makes it clear that this characteristic is not just important, it is vital. This has two important consequences: Without the third characteristic, the charge cannot be a floating charge, and conversely, with it, the charge must be a floating charge and not a fixed one. So any charge whereby the company is allowed to deal with the charged assets and remove them from the charge must be a floating charge and not a fixed charge. The House of Lords' confirmation of the dispensability of the first two characteristics mentioned by Romer LJ as being typical of a floating charge is also useful. In relation to the first characteristic, this means that a floating charge need not necessarily be over present and future property, it can be over present property only or future property only. This proposition is not new[12] but may not have been fully appreciated in the past. In *In re Atlantic Computers Systems Plc*,[13] for instance, the court decided that a charge over sub-leases and rentals was a fixed charge and not a floating one because it related to existing assets and not future assets, a position which is now clearly untenable. As for the second characteristic, its dispensability means that a floating charge need not be over a class of assets which, in the ordinary course of the business of the company, would be changing from time to time. It could be over assets like machinery, a class which is more permanent and which need not change from time to time in the ordinary course of business. Under the *Spectrum Plus* test, that an asset fails to display Romer LJ's second characteristic is immaterial provided that the third characteristic is present. So assets like machinery could be subject to a floating charge as long as the company is allowed under the terms of the charge to deal with this machinery in the ordinary course of business and remove it from the

12 For example, in *Dresdner Bank AG v Ho Mun-Tuke Don supra* n 8, at [39], the Singapore Court of Appeal implied that a charge having only the last two characteristics mentioned by Romer LJ could still be a floating charge.

13 [1992] Ch 505.

charge.[14] Whilst it might be thought that the second and third characteristic usually go together, it should be pointed out that for an asset to display the third characteristic without displaying the second one is not necessarily inconsistent: That a particular class of assets does not normally change from time to time in the ordinary course of business does not mean that a disposal of assets from this class occasionally would take the transaction outside the ordinary course of business. Although the issue is not addressed directly by the House of Lords, it should be noted that the first two characteristics have never been regarded as exclusive to floating charges, and can be present in fixed charges also. So in relation to the first characteristic, a fixed charge can be over both present and future property,[15] and in relation to the second characteristic, there can be a fixed charge over assets that are constantly changing in the ordinary course of business, although this will be impractical and inconvenient because, in accordance with the third characteristic, the assets must not be dealt with without the permission of the chargee.

10 Legal propositions are one thing. How they are applied to the facts can be quite another. The same proposition, applied in a different way, can lead to a different result. In the face of this problem, *Spectrum Plus* advances the law in that it illustrates how the legal test of whether a charge is fixed or floating should be applied in practice. In applying their test of a fixed charge in *Spectrum Plus*, the House of Lords took an approach that was down-to-earth and practical, and focused on the "commercial nature and substance of the arrangement" between the parties.[16] Examples of this will be apparent later in this article. Although this approach was used without fanfare and was not specifically highlighted by the House of Lords, it is an important contribution of the case to the law, as it has managed to bring order to the chaos in this area of the law, caused by an overemphasis on sophisticated legal analysis and theoretical distinctions.

14 This must be distinguished from a fixed charge over the machinery where the chargor would not be allowed to replace worn out machinery except if they are replaced on a unit-by-unit basis, with the replacement machinery then becoming subject to the fixed charge. See Goode, *Legal Problems of Credit & Security*, *supra* n 6, at para 4-12.

15 It is clear that a fixed charge can be taken over future book debts, a point which was confirmed by *Siebe Gorman*, *supra* n 4.

16 *Supra* n 2, at [116] and [155].

B. Support for the test: Historical context

11 In coming to their decisions, both the Privy Council in *Agnew* and the House of Lords in *Spectrum Plus* took into account the historical context in which the floating charge developed and the history of the insolvency legislation that was being considered.[17] The possibility of creating a present security interest over future property sanctioned by *Holroyd v Marshall*[18] led to the rise of arrangements whereby a financier took a charge over the undertaking of a company or a specified class of assets present and future belonging to a company, whilst at the same time allowing the chargor company freedom to deal with the charged assets for the time being owned by it and to dispose of them for its normal business. From a commercial point of view, the chargor's right to deal with the charged assets in the ordinary course of business was a distinctive feature of the new arrangement. Such arrangements later became conveniently referred to as "floating charges" to distinguish them from "fixed" or "specific" charges where the chargor could not deal with the charged assets without the chargee's consent, but these terms were not terms of art, and distinguishing between them did not become important until statutes were enacted which included references to the floating charge.[19]

12 Because the company was allowed to carry on dealing with the charged assets and to dispose of them under a floating charge, two related consequences followed, in turn leading to the "evil" which made statutory intervention necessary. The first was that it was easy for a company to grant a floating charge over practically all its assets as it would still be able to carry on business, and the second was that this state of affairs was possible without the situation becoming apparent to employees and other unsecured creditors. In these circumstances, if the company were to become insolvent, the holder of a floating charge could "step in and sweep off everything" to the detriment of these unsecured creditors. According to Lord Scott of Foscote in *Spectrum Plus*, it was to deal with this "evil" that the predecessors of ss 40 and 175 of the Insolvency Act 1986 (c 45) in England[20] were enacted to give preferential creditors priority over floating charge holders. It was for the same reason that the

17 For the history of the floating charge, see Lord Scott of Foscote's judgment in *Spectrum Plus*, *supra* n 2, at [95]–[98], and Lord Millett's judgment in *Agnew*, *supra* n 3, at [5]–[15].

18 (1862) 10 HLC 191; 11 ER 999.

19 See *Agnew*, *supra* n 3, at [11].

20 In Singapore, see ss 226 and 328 respectively of the Companies Act.

predecessor of ss 395 and 396 of the Companies Act 1985 (c 6) was enacted in England to require the registration of company charges,[21] and the predecessor of s 245 of the Insolvency Act 1986 was enacted to provide for floating charges created by an insolvent company a short period before its winding up to be invalid except to the extent that the chargor had provided new money.[22] The Singapore statutory provisions are equivalent to the English provisions, and a similar analysis will be relevant in Singapore. As these statutes use the term "floating charge" without defining it, the term bears the meaning given to it by judicial decision, and it is therefore right that such decision should take into account the feature of the floating charge that necessitated the enactment of the provisions in the first place.

C. The future?

13 The practical impact of the *Spectrum Plus* decision in the UK might be limited if the work of the UK Law Commission in reforming the law relating to company security interests results in an abolition of the distinction between fixed and floating charges.[23] However, even if a new regime for company security interests is implemented in future, it would be desirable that the long-standing controversy over the distinction between fixed and floating charges over book debts should not be left unresolved. The finality brought about by the latest developments in England would provide a fitting end to the old era.

21 In Singapore, see s 131 Companies Act.

22 In Singapore, see s 330 Companies Act.

23 See *Registration of Security Interests: Company Charges and Property other than Land* (Law Commission Consultation Paper No 164, London: TSO, 2002) and *Company Security Interests* (Law Commission Consultation Paper No 176, London: TSO, 2004). However, indications are that any abolition of the distinction between fixed and floating charges will not affect the existence of preferential debts under insolvency law in the UK, as the recommendations of the Law Commission are meant to be insolvency neutral. Although consequential amendments will have to be made to the insolvency legislation to take into account any new scheme, there probably will still exist a category of security interest which will be subject to the claims of preferential creditors, unless those responsible for insolvency law policy decide to change the special protection now given to preferential creditors. See *Company Security Interests* at para 2.60 and paras 3.410–3.411.

III. Charges over book debts

A. Conflicting results on similar facts

14 The test ultimately adopted by the House of Lords in *Spectrum Plus* to distinguish a fixed charge from a floating charge generally is a familiar one, which makes it surprising that the cases and academic commentators have reached such varying conclusions on what it takes to create a fixed charge over book debts in particular. Two examples, based on common arrangements for a fixed charge over book debts, where different decisions were reached on essentially similar forms of debentures, will illustrate the confusion that reigned before the *Spectrum Plus* decision. The issues raised by these cases will be further discussed later.

15 One example is the arrangement in *Spectrum Plus*, which was an overdraft facility secured by "a charge over present and future book debts, where the chargor cannot dispose of or charge the uncollected book debts but can deal with its debtors and collect the debts and where the chargor is obliged to place the payments made to it by its debtors in a designated account with the chargee bank but can freely draw on the account for its business purposes provided the overdraft limit is not exceeded".[24] Applying the test of a floating charge discussed earlier, the position was this: After the proceeds of the book debts were paid into the bank account with the chargee bank, the chargor was free to draw on the account until a "future event", *ie*, if and when notice was given by the bank to terminate the overdraft facility (as it was entitled to do under the express terms of the bank's borrowing terms) and "appropriate" the proceeds for payment of the chargor's indebtedness. The House of Lords unanimously decided that the charge was a floating charge, and the preferential creditors gained priority over the chargee. This categorisation of the charge can be contrasted to Slade J's view in the earlier case of *Siebe Gorman*, which involved a debenture in a similar form.[25] There, the judge had decided that the charge was a fixed charge.

24 This was Lord Scott's statement of the issue in *Spectrum Plus*. See *supra* n 2, at [83].

25 *Supra* n 4. Exceptionally, *Siebe Gorman* did not involve a competition between a floating chargee and the preferential creditors. In that case, there was a competition between a bank chargee and a subsequent assignee of book debts, and the question turned on whether the assignee had knowledge of the charge and the prohibition against subsequent assignments by the chargor.

16 A different example is provided by *New Bullas*, where the debenture in effect provided for a fixed charge over the book debts of the company whilst these were uncollected, and a floating charge over the proceeds of the book debts after collection. The company was prohibited from disposing of its uncollected book debts and had to pay the proceeds of the book debts into a designated account. It could deal freely in the ordinary course of business with money in the account unless the chargee gave directions to the contrary, which it never did. In the absence of such directions, the proceeds in the account would be released from the fixed charge and subject to a floating charge created by the debenture. The Court of Appeal upheld the parties' freedom of contract and decided that a fixed charge over the book debts was successfully created. This decision enabled the bank to defeat the preferential creditors, as the charge over the book debts was not a charge which, as created, was a floating charge under the s 40(1) of the English Insolvency Act 1986. *New Bullas* was later overruled by the Privy Council in *Agnew*, which reached the opposite conclusion on a charge modelled upon the one in *New Bullas*.[26] To compound the confusion, the *New Bullas* position was later reinstated in England by the Court of Appeal decision in *Spectrum Plus*, where the court did not follow the Privy Council decision in *Agnew*, but thought itself bound by *New Bullas* instead.

17 One reason for such divergence in the results of the cases is the creativity of lawyers and common law judges who were able to develop innovative arguments to support their view that something which looked like a floating charge was in fact a fixed charge. Unfortunately, these arguments obscured the reality of the transaction. *Spectrum Plus* now provides a solution with its back-to-basics approach which is attractive and refreshing and strips this area of the law bare of its artificiality. Another reason, which brings us close to the heart of the debate, is that it is not easy to take a general proposition regarding the essential characteristic of a floating charge, and apply it to a specific type of asset which involved special considerations.

26 One difference between the facts of *New Bullas* and *Agnew* was that in *Agnew*, the proceeds of the charged book debts were released from the fixed charge and subject to the floating charge as soon as they were collected by the company, whereas in *New Bullas*, the proceeds had to be paid into the designated bank account before they were released from the fixed charge. The Privy Council in *Agnew* was of the view that this difference was insignificant as far as the applicable legal principles were concerned. In both cases, the parties intended that the chargor could continue to collect the debts, and that the proceeds which took their place (and had never been subject to the fixed charge) should from the outset be subject to a floating charge: See *supra* n 3, at [28].

B. Main issues in the book debts debate

18 One main issue lay at the heart of the debate on how a fixed charge could be created over book debts. This related to the extent of the restrictions required on the chargor's rights to deal with the "charged asset", in particular, the proceeds of the book debts (hereafter, "the proceeds issue"). There appears to have been no question that in a fixed charge over book debts, there must be restrictions over the chargor's rights to deal with the book debts themselves. This indicates that there must have been a high degree of agreement, at least at the general level, that in a fixed charge, the chargor should not have freedom to deal with the charged assets. It was the proceeds of the book debts that presented a special problem. The chargor was often allowed to collect the book debts,[27] and this raised the question of whether restrictions were also required over the chargor's rights to deal with the proceeds of those debts once they were collected. If so, was it necessary also to restrict the chargor from dealing with any bank account into which the proceeds had to be paid? Further, even if restrictions on dealing with the proceeds or the bank account existed, would the chargee be regarded as exercising sufficient control over the proceeds if there was just a right of intervention on the part of the chargee, so that the chargor could deal freely with the proceeds unless the chargee directed otherwise?

19 There was another issue that had been in the background since the *Siebe Gorman* decision, although it was not highlighted until the *Spectrum Plus* case: Assuming that restrictions over a chargor's rights to deal with the proceeds of the book debts were required in a fixed charge, what provisions should be included in the debenture so that it would be construed as having created a fixed charge? (hereafter, "the construction issue"). In particular, would a *Siebe Gorman* form of debenture be sufficient to achieve this aim?

20 Arguments based on both the proceeds issue and the construction issue would have been relevant on the facts of *Spectrum Plus*, but counsel for the bank focused on the less prominent construction issue rather than the proceeds issue, probably because the proceeds issue had already been dealt with to the bank's detriment by the Privy Council in *Agnew*. The House of Lords in *Spectrum Plus* nevertheless gave their

27 This is unobjectionable, even in a fixed charge, provided that the chargor is collecting the book debts on behalf of the chargee.

opinion on both issues and thereby provided closure on this debate in England.

C. The proceeds issue

(1) Importance of proceeds

21 After the House of Lords decision in *Spectrum Plus*, it became clear that in order to create a fixed charge over book debts in England, there had to be restrictions on the chargor's ability to deal with not just the book debts, but also the proceeds of the book debts, and any bank account into which the proceeds were required to be deposited. This decision vindicated the many judges and commentators who had been of the same view. These included the Irish Supreme Court in *Re Keenan Bros Ltd*,[28] Hoffmann J in *In re Brightlife Ltd*,[29] Tompkins J of the High Court of New Zealand in *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd*,[30] the Privy Council in *Agnew*, Sir Andrew Morritt VC, the first instance judge in *Spectrum Plus*,[31] Prof Goode,[32] and Prof Worthington.[33] Further, if it was ever in doubt before, it is also clear that a right of intervention on the part of the chargee to stop the chargor from using the proceeds (in *Spectrum Plus* there was a right for the chargee to terminate the overdraft facility) is not sufficient in a fixed charge.

22 Given the predominance of judicial opinion regarding the necessity for the chargee to maintain control over the proceeds of book debts in a fixed charge, it was unusual that the debate could have gained such momentum in the first place. The ambiguity of the decision in *Siebe Gorman* was one factor, and the alluring creativity of the Court of Appeal decision in *New Bullas* was another. Both cases will be discussed later. Ultimately, the driving factor for the debate must have been that these two cases gave innovative lawyers the opening they needed to improve the legal position of their financier clients by elevating their status from floating chargees to fixed chargees, and this was an opportunity nobody

28 [1986] BCLC 242.
29 [1987] Ch 200.
30 [1994] 3 NZLR 300.
31 [2004] Ch 337 at 342–356. The Court of Appeal's judgment is reported, *id* at 359–384.
32 Roy Goode, "Charges Over Book Debts: A Missed Opportunity" (1994) 110 LQR 592.
33 Sarah Worthington, "Fixed Charges Over Book Debts and Other Receivables" (1997) 113 LQR 562.

was prepared to give up without a good fight. In English courts, at least, the fight is over.

23 The importance of control over the proceeds in a fixed charge over book debts was well explained by Lord Millett in the Privy Council decision of *Agnew*, and this view was later adopted by the House of Lords in *Spectrum Plus*. This was because the value of a book debt lay in its proceeds, and the debt itself would be "worthless" and "would not be a security at all" if the secured party had no control over its proceeds. Prof Worthington, whose views were quoted with approval in the House of Lords, had put it the most strongly, stating that:[34]

> [T]he categorisation of a charge over receivables requires examination of the permitted dealings with collected proceeds *only* in order to clarify whether the chargor is free to deal with the charged asset itself (the receivable) in the ordinary course of business without the consent of the chargee. [emphasis in original]

24 This position will be better understood if we bear in mind the commercial purpose of a fixed charge, which is to ensure that the asset forming the security is set aside and available to be realised to satisfy the chargor's debt in the event of the chargor's default. In the case of a fixed charge over a tangible asset like machinery, the chargee can achieve this purpose simply by prohibiting the sale, charge or other disposition of the asset by the chargor. The issue of proceeds would usually not even arise. In contrast, where there is a receivable like a book debt, a prohibition against disposition of the debt would provide insufficient control if the chargor is permitted by the chargee to collect the debts when they fall due, as it usually is. The collection of a book debt would extinguish it as a valuable security, and the chargee must assert control over the proceeds, whether in the form of cash or as a deposit in a bank account, in order to fulfil the commercial purpose of taking a fixed charge in the first place. It seems commercially unrealistic that a chargee would allow a chargor to deal with the proceeds of the book debt when the chargee's intention was to set aside the asset as a security under a fixed charge. A focus on the commercial purpose of taking a fixed charge over book debts will also make it clear that the control which the chargee asserts over the book debts and their proceeds must be active control, in the sense that the chargor must be prohibited from removing the book debts or their proceeds from the security without the chargee's consent. If control were limited to passive control, for instance if the chargor were free to deal

34 *Supra* n 2, at [151]. See Worthington, *supra* n 33, at 562.

with the proceeds in a bank account subject to the chargee's right to intervene to stop such dealing, this would again defeat the commercial purpose of setting aside the charged assets to satisfy the debt, as the chargor might dispose of the proceeds before the chargee intervenes. Further, such an arrangement would require the chargee to take the additional step of intervention before the chargor's right to deal with the proceeds is curtailed, and thus display the essential characteristic of a floating charge.

(2) New Bullas*: Fixed charge over book debts, floating charge over proceeds*

25 The Court of Appeal decision in *New Bullas* was a controversial one which fuelled the debate about the requirements for creating a fixed charge over book debts. Reference has already been made to its salient facts. In *New Bullas*, the Court of Appeal decided that it was possible to create a fixed charge over book debts while they were uncollected and a floating charge over their proceeds after they were collected. Nourse LJ, with whom the other two members of the court concurred, was prepared to allow the parties freedom of contract:[35]

> [J]ust as it is open to contracting parties to provide for a fixed charge on future book debts, so it is open to them to provide that they shall be subject to a fixed charge while they are uncollected and a floating charge on realisation. No authority to the contrary has been cited …

26 The House of Lords in *Spectrum Plus* agreed with the Privy Council in *Agnew* that *New Bullas* was wrongly decided.[36] The Court of Appeal in *New Bullas* had failed to appreciate that control over the proceeds of the book debts is vital in a fixed charge. In *Agnew*, Lord Millett said:[37]

> An assignment or charge of a receivable which does not carry with it the right to the receipt has no value. It is worthless as a security. Any attempt in the present context to separate the ownership of the debts from the ownership of the proceeds (even if conceptually possible) makes no commercial sense.

35 *Supra* n 5, at 493.

36 This was important for finality as the value of a Privy Council decision as a precedent against a contrary decision of an English court is unclear. For example, the Court of Appeal in *Spectrum Plus* had felt bound by the decision of the Court of Appeal in *New Bullas* instead of the contrary view of the Privy Council in *Agnew*. See *supra* n 31.

37 *Supra* n 3, at [46].

27 In *Spectrum Plus*, Lord Scott expressed his agreement with the judgment of Lord Millett in *Agnew*, where the latter had "challenged the notion that the security rights granted over a book debt could be any greater than the rights, if any, granted over the money received in payment of the debts".[38] Lord Scott elaborated on this in an illuminating passage as follows:[39]

> If a book debt were to be charged as security but with an accompanying provision that any money received from the debtor in payment of the debt would belong to the chargor, the so-called "charge", whether expressed to be a fixed charge or a floating charge, would not be a security at all. It would not constitute a possible source for the repayment of the allegedly secured debt. As Lord Millett [in *Agnew*] said, it would be worthless. If the accompanying provision were, instead, to say that any money received from the debtor would be subject to a floating charge, that provision would, in my opinion, necessarily describe and limit the nature of the charge over the receivable debt. And if the charge were to be expressed to be a fixed charge as respects the receivable debt but a floating charge as respects the money received from the debtor there would be an internal contradiction in the formulation of the charge.

28 It should be pointed out that in rejecting the analysis in *New Bullas*, neither the Privy Council nor the House of Lords objected to the idea that a book debt and its proceeds are separate assets and are conceptually distinct. Their focus was on the "fixed charge" that was purportedly created over the uncollected book debts, rather than on the floating charge over the proceeds. Did the charge over the book debts satisfy the legal requirements of a fixed charge? Under the view expounded in *Agnew* and *Spectrum Plus*, in order to create a fixed charge over book debts, one has to look beyond the debt to its proceeds, and the chargor must not be allowed to deal with the proceeds of the debts. On the facts of *New Bullas*, as the chargor could deal with the proceeds of the book debts (this was evidenced by the floating charge over the proceeds),

38 *Supra* n 2, at [110].

39 *Ibid*. The House of Lords did not address the possibility of a floating charge over book debts but a fixed charge over its proceeds, but see Goode, *Legal Problems of Credit and Security*, *supra* n 6, at para 4-16, where Prof Goode writes:

> There is nothing to preclude the grant of a floating charge on book debts, giving the chargor freedom to dispose of them in the ordinary course of business, and a fixed charge on the collected proceeds through a requirement that these are to be under the control of or held for the account of the chargee.

the charge over the book debts failed to be a fixed one despite the label given by the parties.[40]

29 To support the argument that the arrangement in *New Bullas* created a floating charge over book debts, counsel referred to the judgment of Vaughan Williams LJ in *In re Yorkshire Woolcombers Association, Limited* where the judge said:[41]

> [W]hat you do require to make a specific security is that the security whenever it has once come into existence, and been identified or appropriated as a security, shall never thereafter at the will of the mortgagor cease to be a security.

In response, Nourse LJ expressed the view that the book debts did not cease to be subject to a fixed charge at the will of the company alone but because both parties had agreed that if the proceeds of the book debts were paid into the specified account when no instructions had been given for them to be dealt in any particular way, it would be released.[42] This view was questioned by the Privy Council in *Agnew*. Lord Millett expressed the criticism persuasively:[43]

> It is entirely destructive of the floating charge. Every charge, whether fixed or floating, derives from contract. The company's freedom to deal with the charged assets without the consent of the holder of the charge, which is what makes it a floating charge, is of necessity a contractual freedom derived from the agreement of the parties when they entered into the debenture. To find the consent in question in the original agreement would turn every floating charge into a fixed charge.

30 The reality is that the event which would cause the asset to be released from the "fixed charge" and subject to the "floating charge" under the *New Bullas* scheme was the act of the chargor in collecting the book debts. Under the terms of the debenture, this could be done without further reference to the chargee. This arrangement clearly contravened the requirements for a fixed charge mentioned by Vaughan Williams LJ and quoted above.

40 The Court of Appeal's decision in *New Bullas* raised the theoretical question of whether it was possible to have two security interests, one over the book debts and a separate one over the proceeds, or whether there was in fact one security interest which changed its character from fixed to floating. See Goode, "Charges Over Book Debts: A Missed Opportunity", *supra* n 32; Alan Berg, "Charges Over Book Debts: A Reply" [1995] JBL 433. This question was not addressed by the Privy Council in *Agnew* or the House of Lords in *Spectrum Plus*.

41 *Supra* n 8, at 294. See *New Bullas*, *supra* n 5, at 490.

42 *Supra* n 5, at 490.

43 *Supra* n 3, at [34].

31 The freedom of contract consideration that influenced Nourse LJ's decision in *New Bullas* is an attractive one at first glance. Indeed, there is academic writing which suggests that it would be desirable to give effect to a *New Bullas* arrangement so as not to force the parties into having to adhere to the strict requirements of a fixed charge and into an agreement that was a pretence, whereby the chargor covenanted not to draw cheques on the bank account without the chargee's specific consent.[44] However, this is overly considerate of the interests of the chargor and the chargee, and fails to take into account the broader interests at stake. As Lord Walker of Gestingthorpe observed in *Spectrum Plus*, in the distinction between fixed and floating charges, "there is a public interest which overrides unrestrained freedom of contract".[45] In his Lordship's view, this interest was in "ensuring that preferential creditors obtain the measure of protection which Parliament intended them to have".[46] This supports the view of the Privy Council in *Agnew*, who did not agree that the parties could make any agreement they liked nor that the issue was simply one of construction of the parties' intention. According to the Privy Council, in order to see if a charge was fixed or floating, a court had to engage in a two-step process: first, to construe the contract to discover the rights and obligations that the parties intended to grant each other, and next, to categorise the charge as fixed or floating according to the law. In the second stage of the process, the intention of the parties was irrelevant. The decision reached by the House of Lords in *Spectrum Plus* clearly reflects this two-staged approach. There, the charge was categorised as a floating charge even though the parties had intended it to be a "fixed" one.

32 Lord Walker, quoted above, might have been impliedly conceding that the *Spectrum Plus* approach limited the parties' freedom of contract. Such a concession seems to be unnecessary. Indeed, the answer to the supporters of the freedom of contract approach in *New Bullas* is that the *Spectrum Plus* approach is not neglectful of freedom of contract within

44 See Berg, "Charges Over Book Debts: A Reply" *supra* n 40. It is interesting that this writer did not seem to see the *New Bullas* approach as being incompatible with an approach similar to the one now taken by the House of Lords in *Spectrum Plus*, where the company had to pay the proceeds of the book debts into a specified account and was prohibited from making withdrawals from that account without the chargee's consent. He saw both these approaches as alternatives, and was of the view that the *New Bullas* approach was a more practical and (at that time) less uncertain one. This suggests that he felt that control over the proceeds were important in a fixed charge, but that such control could be dispensed with where the parties had an agreement to release the proceeds under a floating charge.

45 *Supra* n 2, at [141].

46 *Ibid*.

the boundaries of normal contract law. The parties, as between themselves, enjoy freedom of contract. They can provide for anything that they wish to govern their own relationship. The chargee is at liberty to restrict the chargor's rights to deal with the uncollected book debts and at the same time allow him freedom to deal with the proceeds of these debts. The law will enforce the substantive rights of the parties to the contract *vis-à-vis* each other. As long as both parties adhere to their obligations, neither party can sue the other for breach of contract. Sometimes, that a charge is expressed to be "fixed" or "floating" could be relevant in helping the court to ascertain the intention of the parties regarding their substantive rights against each other, whilst in other instances, the label might add nothing to the substantive rights of the parties as those would already be clearly stated in the debenture. But the law of contract has never allowed the parties to a contract to make rules for those who are outside the contractual relationship, and labelling a charge as a fixed charge or a floating charge could be an attempt to do just that, as the label has legal consequences in relation to third-party rights. For example, under s 328 of the Companies Act in Singapore, the holder of a floating charge enjoys a lower priority than preferential creditors. The chargor and chargee cannot be allowed, by labelling a charge as a fixed charge, to dictate the rights of other persons who might be interested in the charged assets but who are not parties to the contract, such as preferential creditors. There is no need to apologise for this position, as it is a fundamental principle of contract law.

(3) New dimension to the debate: The Court of Appeal's analysis in Spectrum Plus

33 By the time of the Court of Appeal decision in *Spectrum Plus*, the Privy Council decision in *Agnew* had been in place for a few years. Lord Phillips of Worth Matravers MR, with whom the other two members of the Court of Appeal in *Spectrum Plus* agreed, felt bound by the Court of Appeal decision in *New Bullas* rather than by the Privy Council decision in *Agnew*. Such a position might be understandable from the point of view of precedent.[47] But the depth of the controversy in this area of the

47 In *Spectrum Plus*, Lord Scott and Lord Walker agreed with this view on the relative authorities as precedents of *New Bullas* and *Agnew*: *supra* n 2, at [93] and [153] respectively. Baroness Hale of Richmond was of the view (at [163]) that it was open in the future for the House of Lords to decide "that the Court of Appeal, or even the High Court, could decline to follow a previous decision of the Court of Appeal which has been expressly disapproved as part of the ratio decidendi in a case in the Judicial Committee of Privy Council on appeal from a country in which the law on the subject is the same as that in England and Wales".

law was starkly reinforced when Lord Phillips MR came up with a new test to support his decision that the debenture created a fixed charge (although the chargor was allowed to withdraw funds from the bank account into which the proceeds of the book debts had been deposited), despite all that had been said in *Agnew* and despite not having appeared to have disagreed with the substance of that case.

34 Lord Phillips MR explained his view that the arrangement in *Spectrum Plus* created a fixed charge by pointing out that it was of "critical importance" in *Siebe Gorman* and *Spectrum Plus* that the proceeds of the book debts were to be paid into an account with the chargee bank (presumably as opposed to some other third-party bank). He further stated that once the proceeds were paid into the account with the chargee bank, title to the proceeds would pass absolutely to the bank and the bank would then be obliged to repay the money to the customer under the banker and customer relationship as described in *Foley v Hill*.[48] In these circumstances, Lord Phillips MR felt that it was consistent with the existence of a fixed charge for the chargor to be permitted to deal with the bank account:[49]

> Strictly speaking the chargor is neither entitled to dispose of the book debts before they fall due for payment, nor to dispose of the proceeds. What he does enjoy are the contractual rights to payments, whether as a lender or as a borrower, from the bank.

According to this view, the right of the chargor to deal with the bank account was irrelevant to the characterisation of the charge as a fixed charge because this right was the subject of a separate contract between the chargor and the bank.

35 This analysis has been criticised as being "unconvincing and unsound"[50] and was not accepted by the House of Lords in *Spectrum Plus* who felt that the categorisation of a charge depended on "the commercial nature and substance of the arrangement, not upon a formalistic analysis of how the bank clearing system works".[51] To say that what the chargor was dealing with was not the proceeds of the debt in the account, but the bank's money which it was paying to the chargor under the banker-customer relationship might be technically accurate, but it ignores the

48 (1848) 2 HLC 28; 9 ER 1002.
49 *Supra* n 31, at [94] of the Court of Appeal's judgment.
50 Fidelis Oditah, "Fixed Charges and Recycling of Proceeds of Receivables" (2004) 120 LQR 533.
51 *Supra* n 2, at [116].

commercial realities of the situation, which is fatal under the approach taken by the House of Lords in *Spectrum Plus*. Under the *Spectrum Plus* approach, the basic question is: Was the chargor allowed (from the point of view of commercial reality) to deal with the proceeds of the book debts? On the facts, it was, and the charge was therefore a floating charge. In fact, Lord Phillips MR himself must have been influenced, at least intuitively, by the reality of the situation when he implied that a similar analysis would not establish a fixed charge if the proceeds were required to be placed in an account with a third-party financial institution instead, and the chargee was allowed to withdraw from this account.[52] Otherwise, a strict adherence to Lord Phillips MR's technical analysis should have meant that the charge would still have been classified as a fixed charge in this situation, as upon deposit into the account, the proceeds would have belonged to the third-party financial institution and therefore be taken out of the control of the chargor despite the chargor's right to withdraw money from the account under the normal banking relationship. The fact of the matter is that whether the bank gives the money to the chargor as its debtor or creditor under the banker-customer relationship, or whether the bank is actually passing over the proceeds of the book debts to the chargor, the commercial reality is that the chargor is allowed to use the proceeds of the book debts and remove them from the security without further reference to the chargee. That is the mark of a floating charge.

(4) Does it matter whether the bank account is in credit?

36 A question that had been in the background since Slade J's decision in *Siebe Gorman* was whether it would make a difference to the categorisation of a charge whether the bank account into which the proceeds were deposited was in credit or debit. Slade J had said:[53]

> [I]f I had accepted the premise that R. H. McDonald Ltd. would have had the unrestricted right to deal with the proceeds of any of the relevant [book] debts paid into its account, so long as that account remained in credit, I would have been inclined to accept the conclusion that the charge on such book debts could be no more than a floating charge.

52 This must have been why the fact that the proceeds were placed with the chargee bank was of utmost importance to Lord Phillips MR's decision: because otherwise, the charge would not have been a fixed charge.

53 *Supra* n 4, at 158.

This was taken to indicate that Slade J had thought that there was a difference between an account in credit and one in debit.[54] During the first instance hearing, counsel in *Spectrum Plus* had used this point, albeit unsuccessfully, to distinguish that case from *Siebe Gorman* as the account was in debit in *Spectrum Plus*.

37 So does it make a difference whether the account is in credit or debit? The argument supporting the view that it does make a difference is that:[55]

> [T]he payment of the proceeds of a book debt into an overdrawn bank account prevents its further identification or tracing through such debit balance so that it cannot be contended that the company thereby enjoyed an unrestricted use of that book debt or of those proceeds.

On this argument, if the account were in debit, the charge would have been a fixed charge. If the approach of the House of Lords in *Spectrum Plus* is applied, it becomes clear that this argument is misguided. It displays the same technical approach that was evidenced in Lord Phillips MR's argument that a fixed charge had been created because the right to draw on the account was the result of the banker-customer relationship between the chargor and chargee, an argument that was rejected by the House of Lords. Unsurprisingly, the House of Lords in *Spectrum Plus* were of the view that it was irrelevant whether the account into which the proceeds were deposited was in debit or credit, as the question was not a technical one of tracing. The only question was whether the chargor was allowed to draw on the account, and as long as he was, it meant that the proceeds of the debt were not being appropriated to pay the debt owed to the chargee but being made available for drawings by the chargor, and that the charge was a floating charge.[56]

54 See Lord Scott's judgment in *Spectrum Plus*, *supra* n 2, at [117]. From a reading of the *Siebe Gorman* case, however, there seems to be little evidence that Slade J had paid any special attention to the fact that the account was in credit, let alone that he thought an account in credit to be different from one in debit. When he mentioned an account in credit in his judgment, he might have been merely repeating the phraseology that counsel had used previously. It is likely that too much has been read into Slade J's use of the phrase.

55 *Supra* n 2, at [153], quoting from Sir Andrew Morritt VC, the first instance judge, *supra* n 31, at [15] of his judgment.

56 See *id* at [117] and [153].

(5) Restrictions over chargor's rights to deal with proceeds

38 Not every restriction over the chargor's rights to deal with the proceeds of the book debts will point to the existence of a fixed charge. For instance, as discussed earlier, the fact that the chargor's rights might be restricted in the sense that the chargee has a right to intervene and stop it from dealing with the proceeds of the debts is insufficient to create a fixed charge. Instead, such an arrangement displays the hallmark of a floating charge. Provisions of debentures have to be measured against the test laid down by the House of Lords, which is simply, if the chargor has a right to deal with the charged asset and remove it from the security until a future event stops it from doing so, the charge is a floating charge. Extrapolating from this, the converse is that if the chargor cannot deal with the asset and remove it from the security in the absence of a future event which allows it to do so, the charge is a fixed charge. Some difficulty may be presented by the fact that the various degrees of restriction over a chargor's right to deal with the proceeds of the debt represent a continuum, and it is difficult to know where the line falls. Apart from absolutely prohibiting the chargor from dealing with the proceeds at all, the next surest way would be to require the chargor to ask the chargee for permission each time it wishes to use the proceeds. However, this might prove too onerous and impractical for both parties. Another way to satisfy the restrictions for a fixed charge, might be to require the book debts to be paid into a blocked account and allow the chargor to overdraw on another account, into which transfers are made from the blocked account from time to time, a method mentioned by Lord Phillips MR in the Court of Appeal in *Spectrum Plus*. Although this possibility was thought to have been "beyond dispute" by Lord Phillips MR,[57] it might not survive the House of Lords decision in *Spectrum Plus*, and was expressly doubted by Lord Walker, who felt that the possibility, "although no doubt appropriate and efficacious in some commercial contexts, may not provide a simple solution in every case".[58] One way to raise the control wielded by the chargee to a level consistent with a fixed charge might be to ensure that the periodic transfers from a blocked account into an unblocked account as described by Lord Phillips MR are not automatic, but are made only with the express approval of the chargee. However, unless active consideration is given by the chargee each time before permission is granted, it is not clear whether

57 *Supra* n 31, at [99] of the Court of Appeal's judgment.
58 *Supra* n 2, at [160].

this arrangement would pass muster in the post-*Spectrum Plus*, pro-reality environment.[59]

D. The construction issue

(1) Siebe Gorman *overruled*

39 The modern interest in fixed charges over book debts began with the *Siebe Gorman* case, which confirmed in 1979 that it was possible to create a fixed charge over book debts, a view that seems to have been universally accepted. In that case, Slade J was of the view that the charge in question was a fixed charge. This decision has had widespread impact, especially after it was developed upon in *New Bullas*. Debenture holders used *Siebe Gorman* and *New Bullas* as guides in attempts to create fixed charges over book debts that would be free from the claims of preferential creditors, a phenomenon that was illustrated by the facts of *Agnew* and *Spectrum Plus*.

40 In *Spectrum Plus*, the argument for the debenture holders was based primarily on *Siebe Gorman*. It will be recalled that on the facts of *Spectrum Plus*, the chargor was not restricted from dealing with the proceeds of the book debts once they were in the bank account. In order to win, counsel had to argue that this arrangement created a fixed charge. One way would have been to rely on the Court of Appeal decision in *New Bullas*, but given that this case had been recently overruled by the Privy Council in *Agnew*, it would have been a dicey strategy given that it was not clear whether the Court of Appeal or the Privy Council was the binding authority. As the debenture in *Spectrum Plus* was in a similar form to the one in *Siebe Gorman*, counsel for the bank relied on the decision of Slade J to argue that the debenture in *Spectrum Plus* should similarly be construed to have created a fixed charge over book debts. In

59 This writer is of the view that as long as there needs to be express permission from the chargee each time the chargor wishes to transfer money from the blocked account into the unblocked one, active consideration of the request by the chargee every time might not be necessary. So it might not matter if an employee of the chargee is given standing instructions to approve the transfer as a matter of course unless otherwise instructed. This would be an internal matter for the chargee. What is important is that, as far as the chargor is concerned, the chargee must be able to say no at any time. If a chargee were prepared to take the risk of releasing the proceeds from the charge in this manner, it would seem too intrusive for the courts to require that the chargee should always give the matter active consideration. However, if it is found that the parties contemplated that the chargee would never say no to any request to transfer funds, this might kill off the argument that the charge was a fixed charge.

response, the House of Lords overruled *Siebe Gorman* and decided that a floating charge, not a fixed one, had been created both in that case and in *Spectrum Plus*.

41 That the *Siebe Gorman* decision should have been described in the House of Lords in *Spectrum Plus* as "not possible to defend … on any rational basis" is ironic,[60] as it was a first instance decision that had survived for more than 25 years despite having been considered by many courts, including the Court of Appeal and the Privy Council. Apart from Slade J's sterling reputation,[61] there seems to have been two main reasons for this, the first being that Slade J had applied the correct test for a floating charge although he had reached the wrong result, and the second being that the basis for Slade J's decision was not clear, thereby giving the case an elusive quality and making it easier to distinguish than to discredit outright.

(2) Right test, wrong result

42 Like the House of Lords in *Spectrum Plus* and the Privy Council in *Agnew*, Slade J felt that control over the proceeds of the book debts were important. He stated that if the chargor of book debts, having collected the book debts, had had "the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit … the charge on such book debts could be no more than a floating charge".[62] Slade J had therefore applied a test that was consistent with the view of the House of Lords in *Spectrum Plus*, as well as with the other earlier cases that took a strict view of a fixed charge. From the point of view of principle, therefore, *Siebe Gorman* was unobjectionable. This would explain why Slade J's decision was acceptable to even judges who had reached decisions which were contrary to his. In *In re Brightlife Ltd*,[63] for example, Hoffmann J treated *Siebe Gorman* as a case in which it had been found as a matter of construction that "the bank would not have been obliged to allow the company to draw upon the account at a time when it still owed the bank money under the debenture",[64] and distinguished it from the case before him where the book debts would be at the free disposal of the chargor once they were put into the bank account, which was the badge of a floating charge.

60 *Supra* n 2, at [64].
61 This was alluded to by two members of the House of Lords. See *id* at [64] and [147].
62 *Supra* n 4, at 158.
63 *Supra* n 29.
64 *Id* at 210.

43 In coming to his decision that the charge was a fixed charge, Slade J found as a matter of construction that restrictions on the chargor's rights to deal with the proceeds in the bank account had in fact been imposed. The basis for this construction was not clear, but until the *Spectrum Plus* decision, it had not been examined whether this was the right construction to be placed upon the facts in *Siebe Gorman*. The debenture in that case provided that the chargor should pay all proceeds of the charged book debts into its account with the chargee bank, but there was no express restriction against withdrawals from this bank account. Judges in later cases were nevertheless prepared to assume that some restriction was implied, for example, Lord Millett in *Agnew* referred to the account in *Siebe Gorman* as a "blocked account",[65] whilst Lord Phillips MR in the Court of Appeal in *Spectrum Plus* felt instead that Slade J had meant that the bank could exercise a right to block the account into which the proceeds had to be paid.[66] The House of Lords in *Spectrum Plus* decided that apart from the "fixed charge" label given by the parties – upon which, in their Lordships' opinion, too much weight had been placed – there was nothing on the facts of the case that justified Slade J's decision that the debenture created a specific charge on the proceeds of the book debts as soon as they were received and prevented the mortgagor from disposing of an unencumbered title to them without the mortgagee's consent.[67] The account concerned was just a normal current account, and there was nothing in the debenture which qualified that relationship. As Lord Hope of Craighead explained:[68]

> [T]he ordinary relationship of banker and customer does not permit the banker, without notice, to refuse to allow his customer to operate a current account as and whenever he wishes while it is [in] credit or is within the limits of any agreed overdraft.

This meant that the chargor in *Siebe Gorman* could withdraw money from the account and in doing so, remove the proceeds of the book debts from the security. The House of Lords decided therefore that Slade J's construction was wrong and the charge was a floating charge.

(3) Determining the meaning of a contract by custom and usage

44 In the Court of Appeal in *Spectrum Plus*, Lord Phillips MR felt that even if Slade J had been wrong in his construction of the debenture

65 *Supra* n 3, at [48].
66 *Supra* n 31, at [82] of the Court of Appeal's judgment.
67 *Id* at [118].
68 See *id* at [60].

in *Siebe Gorman*, that form of debenture had, by custom and usage, acquired the meaning and effect that Slade J had attributed to it, and therefore created a fixed charge. This was because for 25 years, the form had been used in the understanding that it had that meaning and effect, and banks as well as individuals who had guaranteed the liabilities of companies to banks had relied upon this understanding that the banks would be entitled to look to their charges on book debts without being affected by the claims of the preferential creditors.[69] In the House of Lords, this view was considered by Lord Hope who rejected the argument. Lord Hope's view was that *Siebe Gorman* was a first instance decision wherein Slade J's construction of the debenture had been conclusively shown to be wrong, and those who relied on it must have known that if this happened, like any other first instance decision, it was liable to be corrected by the House of Lords. This is a good position. Whatever its merits as a method of contractual interpretation, custom and usage cannot legitimise a contractual construction that is wrong.

E. Lessons in construction and characterisation of charges

45 Reference has been made to the two-staged test of whether a charge is fixed or floating mentioned by Lord Millett in *Agnew*, involving first the construction of the charge to ascertain the intention of the parties regarding their mutual rights, then characterisation of the charge as a matter of law. Both steps are important. The *Siebe Gorman* case is an example of a situation where a mistake was made during the construction stage of the process. The House of Lords in *Spectrum Plus* found that the intention of the parties in *Siebe Gorman* was to allow the chargor to deal with the proceeds in the bank account. It would automatically follow from this that the correct characterisation of the charge was that it was a floating one. This can be contrasted with the situation in *New Bullas*, where there was no mistake as to the intention of the parties – it was clear that they intended to allow the chargor to deal with the proceeds of the book debts – but the mistake was in the characterisation of such a charge as a fixed one.

46 That the parties describe a charge as a "fixed charge" might be one factor that shows their intention that the chargor's right to deal with the proceeds of the charged assets should be restricted. But as the House of Lords' analysis of *Siebe Gorman* in *Spectrum Plus* shows, a label is inconclusive. To successfully create a charge that a court would construe

69 *Supra* n 31, at [97] of the Court of Appeal's judgment.

as having this effect and consequently characterising as "fixed", it would seem that the "fixed charge" label would need to be supported by something more. It would be best if the rights of the parties are spelt out explicitly in the debenture. Failing that, however, a court might still take into account other matters, such as evidence that the account was in fact operated as a blocked account. Lord Scott stated in *Spectrum Plus*:[70]

> If the account had been treated as a blocked account, so long as it remained overdrawn, it would be easy to infer from a combination of that treatment and the description of the charge as a fixed charge that Spectrum had no right to draw on the account until the debit on the account had been discharged. But the account was never so treated. The overdraft facility was there to be drawn on by Spectrum at will.

47 Apart from the provisions of the debenture and actual practice, further matters that a court might be willing to take into account could include other relevant documents, or the circumstances surrounding the creation of the charge, such as its commercial context.[71]

48 Even careful drafting might not guarantee that a charge would be characterised as a fixed charge by the courts, a point highlighted by Lord Millett's statement in *Agnew* that "it is not enough to provide in the debenture that the account is a blocked account if it is not operated as one in fact".[72] Lord Millett's view was referred to with approval by the House of Lords in *Spectrum Plus*.[73] This means that in addition to looking at actual practice in order to supplement the express terms of a contract and to aid its construction as mentioned in the previous paragraph, a court can also look at what actually happens in practice to see if it corresponds with or contradicts the express terms of the debenture. This development is interesting, for English law has traditionally been wary of referring to the parties' post-contractual conduct in the construction of contracts.[74] The orthodox view is that the meaning of a contract should generally be ascertainable at the time that it is signed. A contract should not mean one thing one day and a different thing sometime later.

70 *Supra* n 2, at [119].
71 *Id* at [157]–[159].
72 *Supra* n 3, at [48].
73 *Supra* n 2, at [140] and [160].
74 See generally Gerard McMeel, "Prior Negotiations and Subsequent Conduct – The Next Step Forward for Contractual Interpretation?" (2003) 119 LQR 272. One exception is where the arrangement is said to be a sham, where post-contractual conduct will be very relevant. See for example, *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 and *Chase Manhattan Equities Ltd v Goodman* [1991] BCLC 897.

However, as the court's aim is to construe the intention of the parties at the time of the contract, it could be argued that all matters which might help to ascertain this intention should be relevant, even if they relate to events after the signing of the contract. After the decisions in *Agnew* and *Spectrum Plus*, it would seem that despite the orthodox view of contractual construction, subsequent conduct is relevant in the characterisation of a charge as fixed or floating, and may possibly be relevant also to construing the intention of the parties. If it becomes normal practice for courts to look beyond the words of a debenture and at actual practice when they decide whether a charge is fixed or floating, it will become all the more difficult for parties to create a fixed charge over book debts unless they adhere strictly to the terms of the debenture.

IV. The position in Singapore

49 As the law of secured transactions and company charges in Singapore is similar to UK law, a decision of the highest court in England should have great persuasive value in Singapore. The identification of the essential difference between fixed and floating charges generally will affect all who deal with corporate and banking law, although the House of Lords' general adherence to the existing freedom of dealing test may mean that any adverse impact will be limited. More significantly, Singapore lawyers who have used forms of debentures similar to the ones in *Siebe Gorman* and *New Bullas* as guides to create fixed charges over book debts, will have to study the latest developments in England carefully. If the Singapore courts take the same approach as the House of Lords in England, neither form will suffice to create a fixed charge. The answer may lie in developing a new form of debenture which imposes greater restrictions over the chargor's right to deal with the proceeds of the book debts. However, the charge created might still be categorised as a floating charge unless such a high degree of control is imposed by the chargee that the chargor might find it impracticable to agree to the terms as they would interfere with its business. The practical result of the developments in England could therefore be that debenture holders might have to contend themselves with a floating charge that is subject to the claims of preferential creditors and live with less protection than they thought they had before, under *Siebe Gorman* and *New Bullas*.

50 Whilst pro-business interests may advocate a legal rule that is more advantageous for commercial parties, the considerations of principle and policy discussed earlier in this article make it desirable for the Singapore courts to take the same position as the House of Lords in *Spectrum Plus*. One of the more compelling reasons to follow the

Spectrum Plus approach lies in the history of floating charges generally and the aims of the statute providing for preferential debts discussed earlier in this article. When assessing the correctness of *New Bullas*, Prof Goode observed that the decision, if correct, would "drive a coach and horses" through the provisions of the insolvency legislation designed to subordinate floating charges to preferential claims.[75] This could not be more true.[76] If it were possible to create a fixed charge over book debts by immobilising the book debts whilst they were uncollected, but allowing the chargor to deal with the proceeds once the debts were collected, it is hard to imagine that a floating charge over book debts would ever be created. This would potentially take every book debt out of the grasp of the preferential creditors, and in a case where the company's assets consist mainly of book debts, leave the preferential creditors with nothing at all, a result which the original statutory provision was intended to prevent.

51 Financiers in Singapore, as in England, might be disappointed, perhaps even indignant, about the decision in *Spectrum Plus*. But the importance of creating a charge that would defeat preferential creditors is probably less than the painstaking efforts to artificially create a fixed charge over book debts might seem to indicate. One might be sceptical, as Lord Scott was in the House of Lords, that banks would be overly disadvantaged by the new developments in the law. In a competitive business environment, Lord Scott felt that banks would have made the same lending decisions even if they had known that they would not be protected by a fixed charge but merely a floating one.[77] Further, even if the fixed charge fails, the debenture holder can still rely on the floating charge which gives priority over unsecured creditors who do not fall within the category of preferential creditors. Although there may be no money left after the preferential creditors are paid, this is not invariably the case. In *Spectrum Plus*, for instance, the amount due to the preferential creditors was just about £16,000 out of some £113,000 that the liquidators had managed to collect in respect of book debts.[78]

52 A rule that is more advantageous for commercial parties would be correspondingly more disadvantageous for the preferential creditors. Under the relevant Singapore statutes, preferential debts which enjoy priority over floating charges include expenses of winding up, and

75 *Supra* n 32, at 602.
76 But see Victor C S Yeo, "Is the Fixed Charge Over Book Debts a Viable Security Arrangement?" (2002) 14 SAcLJ 69 at 82–83.
77 *Supra* n 2, at [122].
78 *Id* at [84].

payments to employees such as salaries and bonuses, retrenchment benefits, workmen's compensation and provident fund contributions. When we consider that preferential debts benefit largely employees of the company, it becomes more difficult to argue that a different approach from that taken in *Spectrum Plus* would better serve the needs of commerce in Singapore. In any case, if it is felt that the business environment might be enhanced by strengthening the protection of floating chargees against preferential creditors, the solution should be for Parliament to amend the relevant statutes and not for the courts to tinker with the meaning of the term "floating charge".[79]

V. Conclusion

53 The decision in *Spectrum Plus* has finally ended the confusion about the distinction between fixed and floating charges over book debts in England. In some senses, it was a debate that need not have been, for the legal principle ultimately applied by the House of Lords was a familiar one that could have been used earlier to avoid the mistakes made in *Siebe Gorman* and *New Bullas*. The mistake in *Siebe Gorman* need not have taken the law off-track, as it could have been relegated to being a quirk of construction, as it was in *In re Brightlife Ltd*.[80] The principle stated was clear and correct and could still have been applied in later cases. *New Bullas* created more serious problems because counsel managed to persuade the Court of Appeal to put aside legal principles relating to the characteristics of a fixed charge in favour of considerations of freedom of contract. That the debate could have been sustained for such a long time despite being an unbalanced one, is a lesson in the power of a fundamentally weak argument if it is presented creatively and purportedly supported by an attractive principle, such as freedom of contract, and if the potential commercial gains are attractive enough. A

79 An interesting development in England is the enactment of the Enterprise Act 2002 (c 40). Section 251 of the Act abolishes the Crown's preferential rights (in relation to social security contributions, and debts due to the Inland Revenue and Customs and Excise) to reduce the list of preferential debts to items like contributions to occupational pension schemes and remuneration of employees. This frees up more money for distribution to the floating chargees and unsecured creditors. In Singapore, comparable items of preferential debts would be taxes and goods and services tax ("GST"). Although these items take priority over the claims of unsecured creditors generally, they do not have priority over the claims of floating chargees in Singapore. To some extent, this could be seen as a pro-business position on the part of the Singapore government that does not prejudice groups like the company's employees. However, unsecured trade creditors would benefit only if GST and taxes are removed from the list of preferential debts altogether, like in England.

80 *Supra* n 28.

similar debate over the distinction between fixed and floating charges over book debts has not yet occupied the attention of the courts in Singapore. With the guidance of the English law developments, hopefully the Singapore legal fraternity will pass from confusion to enlightenment without wasting too much court time.