WITH THE CURRENT CREDIT CRUNCH IT WILL become increasingly important whether a chargee has been granted a fixed or floating charge over a company’s business and assets. This briefing provides an overview of what constitutes a fixed charge as opposed to a floating charge, considers the advantages of both, and looks at the case of Russell-Cooke Trust Co Ltd v Elliott and others, where it was held for the first time that a charge constituted a fixed charge rather than a floating charge as purported in the documents.

DOES THE CHARGEE HAVE A FIXED OR FLOATING CHARGE?

The classic definition of a floating charge is the often quoted threefold definition stated by Romer LJ in Re Yorkshire Woolcombers Association Ltd. Romer LJ stated:

‘... 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 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.’

Romer LJ noted, however, that a charge may be classified as a floating charge even if the charge does not contain all three of the characteristics. Consequently, the essence of a floating charge is that it is not a charge over a specific asset, but over a fluctuating body of assets, which the company granting the charge may continue to use in the ordinary course of its business. The charge hovers above the assets until some event or act is done that causes it to crystallise.

In contrast, the essence of a fixed charge is that it is a charge on a particular asset, or class of assets, that the chargor cannot deal with free from the charge without the consent of the chargee. The fixed charge attaches immediately to the particular asset and the chargee has control.

In determining whether a charge is fixed or floating, the court will consider the terms of the documentation pursuant to which the charge is granted both in terms of the classification in the document and the restrictions and controls asserted in the document over the asset(s). The court will also consider the rights of the chargor and chargee respectively over the assets subject to the charge. It was made clear by the decision of the House of Lords in National Westminster Bank plc v Spectrum Plus Ltd and others that it is important when determining whether a charge is fixed or floating to consider what control the chargee actually exercises in practice. If the reality is that, notwithstanding the terms of the charge, the company can deal with the asset in the ordinary course of its business, then the charge is likely to be floating even if the debenture purports to grant a fixed charge.

RUSSELL-COOKE TRUST CO LTD v ELLIOTT AND OTHERS

This case is unique because it is the only known case where it has been argued that a purported floating charge is in fact a fixed charge. The court, however, applied the same principles as those applied in the many cases where purported fixed charges have been held to be floating charges.

The case concerned a firm of solicitors that had set up an investment scheme under which groups of private clients lent money on mortgage to borrowers. In most cases security was taken over a single property, which was referred to as the principal security. In relation to seven of the loans granted to one borrower, however, additional security was granted over several properties. Mann J referred to this additional security as being secondary security. Mann J was asked to determine whether the secondary security amounted to a fixed or floating charge.

The secondary security was described in the security deed as a charge in favour of the lender by...
way of 'floating deed' over all rights, title, estate and other interests of the borrower in any property that was not effectively mortgaged by way of the principal security. The deed also stated that the charge would be a floating charge unless and until it was converted into a fixed charge pursuant to the document or by operation of law. However, the provisions of the deed set out severe restrictions on the chargor's ability to dispose of, mortgage, transfer, share, license or otherwise deal with the property that was subject to the 'floating deed'.

Mann J held that the rights created by the deed were consistent only with a fixed charge. The chargor was not left free to use the charged assets or remove them from the security and he was of the view that there comes a point when the restrictions on alienation, disposal and dealing were such that the charge could no longer be said to be floating.

**ADVANTAGES OF A FIXED CHARGE**

Whether the company has granted a valid fixed or floating charge to secure a facility becomes important when the company is in default. In this situation, whether or not the charge is repaid any sums owing may come down to whether or not the security held is a fixed or floating charge.

The key advantages of being a fixed charge holder is that a fixed charge will restrict the company from dealing with the assets and generally give priority over a floating charge even if created after the floating charge. There are, however, complex rules on priorities and the charge holders may agree between themselves to alter the priorities of the charges.

In an insolvency situation, the appointed office-holder will seek to realise the assets of the company for the benefit of the creditors of the company. The office-holders will take their fees and expenses first, the fixed charge holder will then be paid from the fixed charge realisations, any preferential creditors will be paid, the floating charge holder will be paid from the floating charge realisations (subject to the prescribed part, if any, which is referred to below) and finally the unsecured creditors are paid. Whilst the amount of any payments made are dependent upon the value of the company's assets and liabilities, in most insolvencies the unsecured creditors will receive a minimal, if any, dividend.

A floating charge holder, in contrast, will receive payment subject to the preferential creditors and the prescribed part. It is therefore important to have a basic understanding of what constitutes a preferential debt and the prescribed part to assist in deciding the importance of having a fixed charge.

Prior to the Enterprise Act 2002 debts owing to the Crown, such as income tax and VAT, had a preferential status. The Enterprise Act 2002 abolished the Crown's preferential status so that these debts now rank as unsecured debts. The only categories of preferential creditors are now contributions to occupational pension schemes, remuneration (which includes accrued holiday remuneration) of employees up to prescribed limits, and certain levies on coal and steel production. The level of preferential creditors may, however, still be significant if there are a large number of employees.

The 'prescribed part' was introduced by the Enterprise Act 2002. Pursuant to s176A of the Insolvency Act 1986 a liquidator, administrator, provisional liquidator or receiver must set aside a prescribed part of the company's net property from the floating charge realisations, which would otherwise have been paid to the holder of a floating charge. The prescribed part is then made available for the satisfaction of the unsecured debts. The section only applies if the floating charge post-dates 15 September 2003. Charge holders with charges that pre-date 15 September 2003 will therefore obtain a windfall as there is no prescribed part, but limited preferential creditors.

The amount of the prescribed part is determined by a sliding scale set out in a statutory instrument, Prescribed Part Order 2003 (SI 2003/2097). Where the net property is less than £10,000, the prescribed part is 50% of that property. Where the net property is over £10,000, the prescribed part is 50% of the first £10,000, plus 20% of the net property over £10,000 up to a maximum of £600,000.

Section 176A(2) of the Insolvency Act 1986 provides that the liquidator, administrator or receiver 'shall not distribute that part to the proprietor of a floating charge except in so far as it exceeds the amount required for the satisfaction of unsecured debts'. There have been differing views on whether this means that a floating charge holder can prove in the prescribed part as an unsecured creditor in relation to any shortfall under its security. Jones Day is currently acting on a case where the court is being asked to determine this question, and Patten J is expected to hand down judgment soon. The judgment will impact on the amount a charge holder receives by way of floating charge realisations.

A fixed charge holder will often have the right pursuant to the charge documentation to appoint a fixed charge receiver over a particular asset. In certain circumstances this can be advantageous, although often the business and assets of a
company can achieve higher realisations if they are sold as a whole and as a going concern.

In line with the control a fixed charge holder has over the assets subject to a fixed charge, an administrator is unable to realise assets subject to a fixed charge without the charge holder's consent or an order of the court.

**ADVANTAGES OF A FLOATING CHARGE**

Whilst the holder of a floating charge will take assets subject to the preferential creditors and prescribed part, a floating charge enables the chargor to deal with the assets subject to the charge in the ordinary course of its business. It is therefore an appropriate form of security to take over chattels that are being sold and replaced regularly. Further, a floating charge covers all remaining assets of the company to ensure that the chargee has as full security as possible.

Prior to the Enterprise Act 2002 the majority of fixed and floating charges gave the charge holder the ability to appoint an administrative receiver. An administrative receiver (as defined in s29(2) of the Insolvency Act 1986) is a receiver or manager of the whole, or substantially the whole, of a company’s property appointed by the holder of a floating charge.

Pursuant to s72A of the Insolvency Act 1986, however, the holder of a qualifying floating charge may no longer appoint an administrative receiver of the company unless one of the exceptions apply. The Insolvency Act 1986 sets out six limited exceptions to the general prohibition in relation to capital market arrangements, public-private partnerships, utilities, urban regeneration projects, project finance, financial markets and registered social landlords.

Instead of appointing an administrative receiver, the Insolvency Act 1986 now permits the holder of a qualifying floating charge to appoint an administrator using an out-of-court route. The out-of-court route is a very straightforward procedure, which simply requires prescribed forms to be filed at court, thereby removing the need to make an application to the court with supporting evidence. In cases of urgency a holder of a qualifying floating charge may also appoint an administrator out of court hours by faxing the documents to the court and filing the original documents at court when it next opens.

Paragraph 14 of Schedule B1 to the Insolvency Act 1986 sets out when a floating charge qualifies, such that the holder can utilise the out-of-court procedure. The instrument qualifies if it:

‘... states that [paragraph 14] applies to the floating charge, purports to empower the holder of the floating charge to appoint an administrator of the company, purports to empower the holder of the floating charge to make an appointment which would be the appointment of an administrative receiver... [or] purports to empower the holder of a floating charge in Scotland to appoint a receiver who would be an administrative receiver.’

In addition, the floating charge or a number of floating charges or other forms of security, at least one of which is a qualifying floating charge, must relate to the whole or substantially the whole of the company’s property.

If there are any prior qualifying charge holders, two business days’ written notice must be given to them. During the notice period the prior qualifying charge holder may consent to the appointment of the administrators or it may decide to appoint its own administrator of choice.

**CONCLUSION**

To ensure a chargee has priority over the assets that are capable of being subject to a fixed charge, but also has the ability to appoint an administrator, if appropriate, a chargee should seek to be granted both fixed and floating charges over the whole or substantially the whole of a company's assets. It should be borne in mind that a fixed or floating charge may not be categorised by the court to be that which it is stated to be in the document. Whether a charge is fixed or floating as labelled will unfortunately always be determined on a case-by-case basis depending upon the particular facts.

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Russell-Cooke Trust Co Ltd v Elliott and others [2007] EWHC 1443

Re Yorkshire Woolcombers Association Ltd [1903] 2 Ch 284

National Westminster Bank plc v Spectrum Plus Ltd and others [2005] UKHL 41