

# Fixed charges over book debts



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A recent House of Lords decision in *National Westminster Bank Plc v Spectrum Plus Ltd & Ors*<sup>1</sup> (**NWB v Spectrum**) has generated some controversy by finding that a form of charge in common use in the UK (and Australia), insofar as it relates to book debts, constitutes a floating rather than fixed charge.

As certain creditors (including employees) are afforded a statutory priority over the debts of the company that are secured by way of a floating charge in a corporate insolvency, the decision has potential implications for financiers, insolvency practitioners, as well those parties who would otherwise be afforded priority if the charge was treated as floating.

## The Facts

The dispute concerned a debenture granted by Spectrum Plus Limited (**Spectrum**) to National Westminster Bank Plc (**Bank**) as security for all monies due, from time to time, to the Bank from Spectrum pursuant to an overdraft facility.

The debenture was expressed to create a specific charge over all the book debts owing to Spectrum and required that Spectrum deposit the proceeds of such book debts into the account it operated with the Bank. The debenture also prevented Spectrum from selling, discounting, or otherwise assigning or factoring the debts without the prior consent of the Bank and if requested additionally, Spectrum was required to execute legal assignments of the book debts to the Bank.

Sometime later, Spectrum resolved to go into creditors' voluntary liquidation and its liquidators collected the book debts that were the subject of the purported fixed charge. The Bank claimed to be entitled to the proceeds of the book debts collected by the liquidators, which would otherwise be available for distribution among priority creditors.

At first instance, the Chancery Division found that the terms of the debenture entitled Spectrum to collect the book debts and use the proceeds in the ordinary course of business, unless and until the Bank took steps to intervene. These were characteristics of a floating (rather than fixed) charge, and consequently, the Court considered that the debenture could not constitute a fixed charge over the book debts.

## The Court of Appeal decision

In May 2004, the Court of Appeal reversed the decision at first instance. In particular, the Court pointed to the fact that the debenture required Spectrum to deposit the proceeds from the book debts into the account it operated with the Bank (as opposed to a third party bank) as evidencing the type of control or restriction akin to a fixed charge.

Once the proceeds of the book debts were deposited in the account, title to those proceeds passed absolutely to the Bank. This fact, together with the restrictions placed on Spectrum's rights to deal with the book debts, were together considered sufficient at law to create a fixed charge.

## The House of Lords decision

The priority creditors of Spectrum subsequently sought to appeal the Court of Appeal decision, which was heard by the House of Lords. In judgments favoured by acerbity for financiers using fixed charges as a means to defeat the statutory priority afforded to certain creditors, the House of Lords unanimously reversed the Court of Appeal decision finding that the charge in respect of books debts was floating.

While the Lords were of the view that it was possible for a company to grant a fixed charge over its book debts, little guidance was provided as to the circumstances in which such a charge would exist.

In the present circumstances, merely requiring Spectrum to deposit funds into a specific account, which it was then entitled to draw on, was not considered a sufficient restriction on the rights of Spectrum to deal with the book debts such that the charge could be considered fixed.

## Possible implications

While it is likely that a debenture allowing the a borrower to deal with book debts and the proceeds thereof only with the consent of the financier would be sufficient to create a fixed charge over those book debts, it is unclear what lesser level of control will result in the same outcome as a matter of law.

Despite the fact that the decision in *NWB v Spectrum* is not binding on Australian courts, it represents persuasive authority as to the treatment of purported fixed charges over book debts where there is otherwise a dearth of probative decisions. ■

1. [2005] UKHL 41.

## Quick Quiz answers

- 1.a) Judge John Roberts Jnr.
- 1.b) Justice Sandra Day O'Connor, the first woman to serve on the US Supreme Court.
2. The Hon David Hawker MP.
3. Originally, it was United Nations International Children's Emergency Fund, now shortened to United Nations Children's Fund.
4. David Lange.
5. Western Australia.
6. Sausage Software, Keycorp and Computershare.
7. 1970
8. The Hon Morris Iemma MP.
9. Niger.
10. Albert Einstein's Theory of Relativity.
11. December 2001.
12. O.J. Simpson's attorney Johnnie Cochran.
13. The Caspian Sea.
14. Ned Kelly hanged 1880; World War One ended 1918; and Whitlam Government Dismissed by Governor-General Sir John Kerr 1975.
15. Justice Michael McHugh.