

Books

Review of COMPANY CHARGES: *SPECTRUM* AND BEYOND, edited by Joshua Getzler & Jennifer Payne (2006)

PETER TURNER*

This book contains essays worked up from papers delivered to a conference at Oxford University in September 2005, shortly after a warm summer in which the House of Lords decided *In re Spectrum Plus Ltd (in liq)*.¹ In that case, referred to in the book's subtitle, the House had to decide whether a company charge was subject to s 175 of the *Insolvency Act* 1986 (UK), which provides:

1. In a winding up the company's preferential debts (within the meaning given by section 386 in Part XII) shall be paid in priority to all other debts.
2. Preferential debts — (a) rank equally among themselves after the expenses of winding up and shall be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions; and (b) so far as the assets of the company available for payment of general creditors are insufficient to meet them, have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the company, and shall be paid accordingly out of any property comprised in or subject to that charge.

'Floating charge' is defined by s 251 to mean 'a charge which, as created, was a floating charge'. Though more limitedly, corporate insolvency legislation in Australia also makes preferential debts payable out of floating charge proceeds: see especially *Corporations Act* 2001 (Cth) ss 555, 556, 561.²

As a matter of financial and legal language, a company charge that is not 'floating' is 'fixed'; s 175 picks up this usage. The difficulty in *Spectrum* was that the charge was not drafted in either of the traditional forms for which these terms were developed.³ The charge purported to be a fixed charge over book debts and a floating charge over collected proceeds of the book debts. It was apparently thought that if the charge worked according to its tenor, it was a fixed charge 'as created', and, if effective, would favour the chargee bank because s 175 would not apply, thereby disfavouring preferential creditors. But the House of Lords decided that the charge was, as created, floating over both book debts *and* proceeds, thus subjecting the bank to the claims of preferential creditors. In reaching this decision, the House purported to overrule a decision taken to stand for the opposite

* W M Tapp Scholar, Gonville and Caius College, Cambridge.

1 [2005] 2 AC 680 ('*Spectrum*').

2 See also *Corporations Act* 2001 (Cth) s 433, which ordains payment of certain debts out of property subject to a floating charge in priority to claims under the charge, where winding up has not commenced or been ordered.

3 The main forms are set out and critically discussed in Richard Nolan, 'Property in a Fund' (2004) 120 *Law Quarterly Review* 108.

result⁴, and to follow the Privy Council in *Agnew v Commissioner of Inland Revenue*,⁵ a New Zealand appeal.

The issue presented was narrow but considerably wider issues arise, as this book of essays shows. Is the *Spectrum* reasoning convincing on its facts? How far will it extend to different facts? Did the House have a full understanding of the nature and function of the floating charge? Questions of policy soon appear. Is the fixed/floating charge distinction a helpful one in itself, and as a trigger for redistributing proceeds of company assets? These are not peculiarly English issues. They arise in jurisdictions (including Australia) in which the *Spectrum* reasoning is persuasive and legislation follows a similar pattern, and where practitioners may have to confront English law.

Lord Millett's stylish foreword looks to the past to look to the future. He mentions significant turnings and arguable wrong turnings in the history of the floating charge, but leaves open what should happen now. Support for statutory reform quickly becomes the dominant theme of following chapters. Gabriel Moss, lead counsel for the bank in *Spectrum*, pleads for removal of the fixed/floating charge distinction from the statute book not simply because the distinction is difficult, but because the floating charge itself is 'fictional' (pp 2–3). The fixed charge by contrast is considered 'a reality': hence it is said that in struggling to distinguish between fixed and floating charges in particular cases, 'the courts have throughout been trying to distinguish between a reality and a fiction' (p 4, emphasis original).

The next two papers do not criticise the *Spectrum* reasoning as such. Sir Roy Goode does criticise the floating charge though, if less severely than Moss. Goode has long argued for statutory personal property laws in England, and does so here when arguing for what he terms the 'abolition' of the floating charge 'as a distinct security device' (p 14). 'We can no longer manage effectively with legal rules based on a mass of case law, much it conflicting or unclear, on which are superimposed the priority effects of registration provisions that were never designed for that purpose' (pp 22–23). Sarah Worthington says reform is due because the fixed/floating charge distinction is too difficult and artificial, and because the reasoning in *Spectrum*, though 'perfectly proper — indeed, inevitable' (p 25), could apply elsewhere with bad effects.⁶

Louise Gullifer and Jennifer Payne argue that reform is needed because the fixed/floating charge distinction is not the best trigger for the consequences brought about by s 175. They review functionally equivalent systems in Canada,

4 *Siebe Gorman and Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142.

5 [2001] 2 AC 710.

6 Leaving aside whether the claim of inevitability is true, the claim itself makes more sense once it is understood that some of Worthington's work was cited approvingly by the Privy Council in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 at [35], and the House of Lords in *In re Spectrum Plus Ltd (in liq)*: [2005] 2 AC 680 at [54] (Lord Hope of Craighead); [139], [151] (Lord Walker of Gestingthorpe). A similar point applies to Goode, whose work was also cited approvingly in both cases: *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 at [11], [35]; *In re Spectrum Plus Ltd (in liq)* [2005] 2 AC 680 at [92] (Lord Scott of Fosco), [135] (Lord Walker).

New Zealand and the United States, each of which works without a concept of floating charge, providing a useful introduction particularly for readers not already familiar with these different systems. Australia is not examined: there is 'little to be gained from studying [Australia] on this issue' of 'triggers' because there has been little litigation on the point. It is not a serious criticism, but one wonders if lack of litigation is a decisive reason for ignoring Australia. *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liq)*⁷ was admittedly a case on charge registration rather than preferential debts payable out of floating charge proceeds, but might it have provided useful analogies? Might not the current Australian legislation, which gives the floating charge less importance than the English system but more importance than the Canadian, New Zealand and American systems, have provided useful comparisons against those systems?

Nicholas Frome and Kate Gibbons justifiably fear that *Spectrum* could be applied disruptively to other fields of commerce, and favour reform to eliminate that possibility. Phillip Wood's reform argument echoes Goode's: the original purposes of developing and using floating security no longer exist and legislation based on it is outdated. More radical is John Armour's interesting argument against not just the suitability of the fixed/floating charge distinction, but against the distributive policy in total.

The essays not expressly advocating reform address a range of distinct but mostly relevant matters.

Robert Stevens discusses the objectives of the *Enterprise Act 2002* (UK); whether those have been met; and charge characterisation post-*Spectrum*. Aside from the part on characterisation, there is little here for Australian readers to consider applying locally.

Look Chan Ho argues passionately against an English decision⁸ said to deny recovery in unjust enrichment to a liquidator against debenture holders who, under a 'mistake of law' about the character of the charge, have been paid floating charge proceeds which should have been paid to preferential creditors. This is interesting and matters practically, but the analysis used is unlikely to find favour in Australia.⁹ Incidentally, this is the only paper that touches (very lightly) on the discussion by their Lordships of 'prospective overruling'.¹⁰

Economic history fuels Joshua Getzler's novel contribution. He takes evidence from that field in order to test, and ultimately reject, three assumptions commonly made about development of the floating charge in late Victorian England, and

7 (2000) 202 CLR 588.

8 *Re BHT (UK) Ltd* [2004] 1 BCLC 568 (EWHC Ch).

9 Contrast the four-element formula for recovery in unjust enrichment, stated at 174 and worked out in the rest of the paper (and seen in fragments in *Re BHT (UK) Ltd* [2004] 1 BCLC 568 at [19], [21], [24] itself), with the approaches in *Roxburgh v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516. Further, the discussion of 'receipt-based liability' rests on thinking which it might be thought is unlikely to survive the High Court decision in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2006] HCA Trans 682, [2006] HCA Trans 684.

10 On *Spectrum*, Duncan Sheehan & Arvind Thattai, 'Prospective Overruling and the Fixed/Floating Charge Debate' (2006) 122 *Law Quarterly Review* 20. On prospective overruling in Australia, see *Ha v New South Wales* (1997) 189 CLR 465 at 503–504, 515.

made in *Spectrum* by Lord Scott of Foscote:¹¹ that equity investment was scarce, causing companies to seek to raise debt; that circulating capital was preponderant within such companies; and that lenders providing debt needed improved security over this circulating capital. Further, and in contrast to the usual celebration of the floating charge, Getzler asks whether the floating charge has had *inimical* effects on industrial finance. Assumptions are frequently made about the history of the floating charge: this paper is a valuable warning against doing so.

Julian Franks and Oren Sussman look to present-day economic evidence to query trends such as the feeling, reported in several countries, that domestic insolvency laws are inadequate. Hopeful reformers in one jurisdiction look fondly on foreign insolvency regimes which, ironically, are criticised by those who live with them. The authors neither openly support nor criticise s 175 of the English Act, but prefer private administration of insolvency procedures to state regulation.

Finally, Stuart Bridge examines the English Law Commission's report, *Company Security Interests*¹² which stops short of proposing removal of the fixed/floating charge distinction — an idea favoured during the inquiry, but abandoned because of time constraints. He sketches features of the Commission's proposals and gives life to them by indicating why they were made, and what practical benefits or deficits they might have. Interestingly, he concludes by advocating establishment of an English counterpart to the American Law Institute to assist in such projects as the Law Commission currently receives, and which he says would 'do much to break down the barriers between academics and practicing lawyers' (p 290).¹³

As the above summary hints, this work will find its audience in reformers of laws on corporate insolvency, security and personal property, and with others not engaged in law reform, but who are interested in it — be they in England, Australia or elsewhere.

That the conflicts in views of the various commentators stimulate further ideas for reform is good and timely. At the time of writing, the Standing Committee of Attorneys-General is undertaking a review of personal property security laws in Australia, with a view to simplified national laws based on the economic substance rather than the legal form of transactions.¹⁴ Models from Canada, New Zealand and the United States are being examined. The floating charge could therefore disappear from the statute book. Interestingly, the tone of the available material makes reform seem likely.

It is suggested it is not irrelevant, even if a new personal property securities system is inevitable. Around half the essays discuss and support reform of English laws, giving perspective to the Australian debate. At least some practitioners in Australia will continue to confront floating charges governed by Australian or

11 *In re Spectrum Plus Ltd (in liq)* [2005] 2 AC 580 at [95].

12 Report No 296, (2005).

13 See Radcliffe's remarks on the division: Cyril Radcliffe, *The Law and Its Compass* (1960), at vi.

14 See Standing Committee of Attorneys-General, Australian Attorney-General's website, <http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews_personalpropertysecuritiesreform_Personalpropertysecurities> accessed 31 January 2007.

English law — if only in the transition to new legislation — making the discussion of general principle in some of the papers relevant. Further, only by understanding what the law is and how it has evolved can we settle on the best way to change it. Even if historical and doctrinal knowledge are to play no part in statutory reforms (which one hopes will not be the case), common law technique often revives old concepts for new purposes in unexpected ways. That could happen to the floating charge, which does make it important to understand the relevant history and doctrine.

Reform aside, there is material too for the practitioner of English law engaged with drafting and interpreting security instruments: all agree that *Spectrum* leaves uncertainty (the only question is: how much and what about?), and it will fall to drafters to respond to that. On the other hand, there is relatively little in the essays collected here that can be applied directly by Australian practitioners to today's transactions and disputes.

In this regard, some thought-provoking discussion of the doctrinal nature of the floating charge provides possibilities. An 'overreaching' theory of the floating charge is explicitly accepted to different degrees in two papers, and could become more influential. The idea is that the company charge, like the trust, functions through 'overreaching'. Creation of a floating charge immediately vests an equitable proprietary interest in the chargee, yet permits the chargor (who remains legal owner of the assets) to, say, sell charged assets in the ordinary course of business free of the chargee's interest; 'overreaching' operates by extinguishing the chargee's interest, and 'transferring' it (unless the charge otherwise provides) to the proceeds of sale. Where the chargor deals with a charged asset other than as permitted, the chargee's interest survives in the hands of third parties unless defeated by a defence of bona fide purchase for value without notice. Absent that defence, the chargee may claim the asset to have it restored to the fund of secured assets, and may seek execution of the security according to its terms.¹⁵

The chief exponent of this theory is Richard Nolan. Worthington here accepts the theory.¹⁶ Gullifer and Payne's attraction to it is tempered by two objections. They point out that (a) courts have not adopted the theory, therefore (b) it cannot be said to represent the law. Now, (a) is true but does (b) follow?

Nolan's evidence comes from the fragments of debentures seen in reported cases, and the fuller evidence in floating charge precedents in the early period of the floating charge. As he points out, in enforcing floating charges the courts endorsed this drafting, and the development of the floating charge through successive cases can only be understood alongside developments in the drafting of instruments on which the courts decided those cases.¹⁷ Previous accounts of the

15 Nolan, above n 3 at 117. Particular themes in the article are further developed in two later articles focusing on the trust, but arguably contain scope for further illuminating the company charge: see Richard C Nolan, 'Equitable Property' (2006) 122 *Law Quarterly Review* 232 and 'Understanding the Limits of Equitable Property' (2006) 1 *Journal of Equity* 18.

16 At p 38 Worthington says that Nolan 'argues that ... a floating chargee holds an overreachable fixed charge'. It is debatable whether this summary strictly reflects what Nolan says, but in substance it appears that Worthington does accept Nolan's arguments.

17 Nolan, above n 3 at 117.

floating charge have not used this vital resource which is implicit or explicit in the cases, and therefore represents or at least reflects the law.

Gullifer and Payne also object that Nolan's explanation reduces the floating charge to a specific mortgage coupled with a licence, which Buckley LJ famously said the floating charge is not.¹⁸ However, Buckley LJ's 'specific mortgage' is not a specific (fixed) *equitable* charge, but a specific (fixed) *legal* one. Victorian cases commonly described executed legal mortgages (also called charges) 'specific' and 'fixed', and Buckley LJ worked in that tradition. The second objection thus disappears.¹⁹ If obstacles lie in the path towards accepting the overreaching theory of the floating charge, they must lie elsewhere than here. While also raising conflicting views, such discussion as there is of the doctrinal nature of the floating charge is helpful given that it is not a purely theoretical point. It animated their Lordships in *Spectrum*, for instance, and a clearer view on the matter could both have assisted simpler resolution of the case and have informed legal change, if that is to occur.

Discussion in the essays of other general points that could be of relevance to Australian lawyers depends on differences between English and Australian law which will affect the weight Australian readers give to particular views expressed, irrespective of whether the English or Australian law on any point is the "correct" version. Contractual interpretation shows marked differences. Whereas the trend of High Court authority in the last decade or so has been to settle (or re-settle) principles in this field,²⁰ there is debate in England about both what significance the words of a contract have²¹ and the role of the sham "doctrine". And in property law, current English and Australian views of the legal relationship between income-producing assets and the income ("proceeds") itself will surprise adherents to stock Australian authorities such as *Norman v Federal Commissioner of Taxation*,²² *Shepherd v Federal Commissioner of Taxation*²³ and *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liq)*.²⁴ Many other examples may be found.

The essay topics have been well chosen to minimise unnecessary duplication of material, which indicates thoughtful organisation by the editors, who also arranged the conference from which this volume grew. As to production, the volume is solid and looks pleasant. Pages have substantial margins for annotation, and proofreading has eliminated most errors. It is a shame that Lord Millett's foreword was not corrected to remove the assertion, as yet unsupported by the *Corporations Act 2001* (Cth), that Australia has 'abolished' the floating charge.

18 *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979 at 999.

19 See also Nolan's own comments on *Evans*: above n 3 at 125.

20 Eg, *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liq)* (2000) 202 CLR 588; *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451; *Equiscorp Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471.

21 For example, if the parties' agreement says "this is a floating charge", is the label meaningless or relevant but not decisive or something else? See at vii (Lord Millett: label irrelevant), at 36 (Worthington: irrelevant), 54, 68 (Gullifer and Payne: relevant but not decisive).

22 (1963) 109 CLR 9.

23 (1965) 113 CLR 385.

24 (2000) 202 CLR 588. See discussion in the book at 33–36 (Worthington), 108–109, 111–116 (Frome and Gibbons), 165–166 (Stevens).