Charge Document A Contains the Following Provisions:

(a) “The Company with full title guarantee hereby charges with the payment of all money and liabilities and other sums hereby agreed to be paid or intended to be hereby secured … and so that the [charge] hereby created shall be a continuing security .. all book and other debts of the Company both present and future ..”

(b) “The security hereby created shall as regards [book and other debts] be a fixed charge”.

(c) “The Company with full title guarantee hereby charges with payment of all money and liabilities hereby agreed to be paid or intended to be hereby secured … and so that the [charge] hereby created shall be a continuing security … the undertaking and all property and assets of the Company both present and future including (without limitation) the [book and other debts] if and in so far as the charge thereon or on any part thereof shall for any reason be ineffective as a fixed charge”.

(d) “The security hereby created shall as regards [the undertaking and all property and assets] be a floating charge”.

(e) “The Company shall at any time if and when required by the Bank promptly execute in favour of the Bank or as the Bank may direct such further legal or other assignments, mortgages, charges or other securities … as the Bank shall reasonably require of and on all or any of the [book and other debts] to secure all money and liabilities and other sums hereby agreed to be paid or intended to be hereby secured, such assignments, mortgages, charges or other securities to be prepared by or on behalf of the Bank … and to contain all such clauses for the benefit of the bank as the Bank may reasonably require ..”

(f) The Company shall not (without the consent in writing of the Bank):

   (i) create or allow to subsist any mortgage, debenture, hypothecation, charge, assignment by way of security, pledge or lien, or any other encumbrance or security whatsoever (save a lien arising by operation of law in the ordinary course of business) upon the [book and other debts] or any part thereof”.

   (ii) sell, assign, discount, factor or otherwise dispose of, or deal in any other way with, the [book and other debts] provided that this sub-clause shall not prevent the Company without such consent collecting the proceeds of the book and other debts ... and paying the same into the Company’s account or accounts with the Bank in accordance with clause [g] and provided further that where the Bank makes a payment at the request of the Company which is debited to any account with the Bank which is for the time being in credit, the Bank shall be taken to have given any necessary consent for the purposes of this clause to such payment unless such payment was made as a result of some mistake of fact on the part of the Bank.”
(g) During the continuance of this security, the Company shall pay into its account or accounts with the Bank all moneys which it may at any time receive in respect of its [book and other debts] [hereby charged by it] and pending such payment shall hold such money on trust for the Bank."

Charge Document B Contains the Following Provisions:

a) Each Company with full title guarantee hereby charges to the Security Trustee with the payment of the Secured Obligations and so that the charges hereby created shall be a continuing security the Undertaking and all property and assets of the Company both present and future including (without limitation) …all book and other debts of the Company and the proceeds thereof.

b) The security hereby created shall as regards [book and other debts] … be a fixed charge.

c) The charge hereby created shall extend as a floating charge to the Undertaking and all property and assets of each Company both present and future including (without limitation) the book and other debts and proceeds thereof if and in so far only as the charge thereon or on any part thereof created by this deed shall for any reason be ineffective as a fixed charge.

d) Each Company shall at any time if and when required by the Security Trustee promptly execute in favour of the Security Trustee or as the Security Trustee shall direct such further legal or other assignments, mortgages, charges or other securities… as the Security Trustee shall reasonably require of and on all or any of the [book and other debts] to secure the Secured Obligations, such assignments, mortgages, charges or other securities to be prepared by or on behalf of the Security Trustee… and to contain all such clauses for the benefit of the Security Trustee as the Security may reasonably require….

e) During the continuance of this security, each Company covenants that unless otherwise agreed in writing by the Security Trustee it will not…create or allow to subsist any Security Interest on the [book and other debts] except for a Permitted Security Interest.

f) During the continuance of this security, each Company covenants that (unless otherwise agreed in writing by the Security Trustee) it will not sell, assign, discount, factor or otherwise dispose of, or deal in any other way with, the [book and other debts] provided that this clause shall not prevent the relevant Company without such consent collecting the proceeds of its book and other debts…in the ordinary course of the Company’s business and paying the same into an account with the Security Trustee or nominated by the Security Trustee in accordance with clause [see (g) below].

g) During the continuance of this security, each Company covenants with the Security Trustee that it will…pay into its account or accounts with the Security Trustee or such other account or accounts as the Security Trustee may nominate for this purpose all monies which it may at any time receive in respect of its [book and other debts] and pending such payment shall hold such monies on trust for the Security Trustee.
Does the Charge Over ‘Book and other Debts’ in Charge A Extend to Include the Proceeds of those Debts? If So, Does this Affect its Classification as a Fixed or Floating Charge?

According to the FLP, in the light of the Privy Council’s decision in Agnew, it is likely that if these issues were to come before a senior English Court in similar factual circumstances, it would be likely to deal with them along the following lines:

- In Charge A, the relevant item of property is described simply as ‘all book and other debts’ (see clause (a)). The charge is said to be a fixed charge, with a saving provision that, if for any reason it should be ineffective as a fixed charge, it should be effective as a floating charge. Hence the property expressed to be subject to a fixed charge does not refer specifically to the proceeds of the debts. The question then arises whether it could be argued that the proper construction of Charge A is that it was intended to create a fixed charge only over unpaid debts, and that the proceeds were included within the assets which are agreed to be subject to a floating charge. On this argument the fixed nature of the charge over unpaid debts would not be affected by the liberty on the part of the chargor to deal with the proceeds.

- This argument would not succeed. In Charge Document A, in clauses (f) and (g), it is clear that the draftspeople believed that the proceeds of charged debts were to be subject to the fixed charge, since provision is made for dealing with them on that basis. The charge over book debts contained in Charge A is a floating charge, notwithstanding this drafting for the reasons given below. However, the attempt to create a fixed charge which included the proceeds, although ineffective, makes it impossible to argue that the draftspeople intended all along that the proceeds of the charged debts should be treated in a way which was different from the debts themselves.

Is the Position Different as Regards Charge Document B, Where the ‘Book and Other Debts’ and ‘the Proceeds Thereof’ are Charged as Separate Items?

- In Charge B the wording is a little different. In that case the charged property is described as “all book and other debts of the Company and of the proceeds thereof”, while the property which is expressed to be subject to a fixed charge is ‘book and other debts’. Thus, an argument might be made that the document drew a literal distinction between the debts and their proceeds. The proceeds of the debts would be caught by the general floating charge over the assets of the company, but were not within the wording of the fixed charge provision.

- While this argument may be ingenious, it is not convincing as evidence of the intention of the parties, in the light of other provisions of the charge document. In particular, the provision in
paragraph (g) requiring the proceeds of the debt to be paid into a specified bank account, and providing that until such payment the proceeds should be held on trust for the chargee is quite inconsistent with an intention of the parties to create over the proceeds of the debts a floating charge only. In this particular security it is clear that the book debts and the proceeds were treated together and that the chargee purported to take security over the proceeds which was in the nature of fixed security. The attempt to create a fixed charge here is also unsuccessful for the reasons given below.

Fixed or Floating? – The FLP’s Verdict

- In the opinion of the FLP both charge documents A and B would have been unsuccessful in creating a fixed charge over the book debts (and its proceeds).
- According to the FLP, the key to deciding whether a charge is, or is not, floating lies in the construction of the words used in the charging document. But these words must be considered in context. A court will examine the terms of an agreement in the commercial context in which the arrangements take effect: Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 All ER 98; Charter Reinsurance Co. Ltd v Fagan [1997] A.C. 313.
- This will be particularly important in the case of documentation which creates security. Security documentation is often in a standard form, drafted by the legal advisers to commercial bankers to produce an optimal position for their client, but without reference to a factual situation. The documents will purport to give to the chargee very wide powers of control and will deny these rights to the chargor. A provision that, for example, the chargor will not deal with its debts at all, save to collect them and hold them on trust for the chargee, is intended by the draftsman to give the chargor a degree of control which is consistent with a fixed charge. However, if both the chargor and chargee know that the chargor will (and in commercial terms, must) be allowed to use its cashflow to operate its business, words in a debenture which purport to deny this ability will not of themselves be enough to preclude the conclusion that the security is a floating charge. The same result may be reached even where the security document explicitly describes a charge as ‘fixed’ or ‘floating’, (or states that the parties do not intend to create a charge).
- As far as the generality of debts of trading companies is concerned, it will be difficult to establish that a charge is fixed. The need for the chargee to exercise close and genuine control over the use of the debts and their proceeds will make a fixed charge in many circumstances commercially impractical.
- This is not to say that it is impossible to take a fixed charge over debts or other intangibles. A prime example of where it is possible is that of a fixed charge over a portfolio of securities. In the securities industry, it is common for a company to give to a financier a fixed charge over an identified portfolio of shares or bonds. Usually the charge will provide for substitution: the chargor is allowed to ask for consent to dispose of securities free from the charge and the chargee binds itself to agree to release them, provided that the chargor then brings within the fixed charge new securities acceptable to the chargee. It is perfectly possible for such an arrangement to take effect as a fixed charge provided that the wording reflects the real
intentions of the parties. If on the other hand, the chargee does not insist that the chargor
obtain the approval of the chargee to substitutions of securities, a Court might hold that the
arrangements allowed the chargor to deal with the charged assets free of the chargee’s control
(and it would be likely to find such a charge a floating charge). If the chargee requires only that
the chargor should maintain the value of the charged pool at a particular level, and it is given
discretion as to the way in which this is achieved (whether explicitly or in practice by the
conduct of the chargee), the charge will probably be a floating charge.

In Summary ……

• We are yet to have a comprehensive authoritative statement in this area of law from the
Australian courts. Until such a time, in the light of the Privy Council’s decision in Agnew, the
following should be noted:

• Fixed charges over book debts will only be found in limited circumstances. Fixed charges over
book debts will in fact be floating charges if the chargor can in effect exercise complete control
over (without necessarily having the chargee’s consent):
  a) the collection of the book debts and the proceeds;
  b) the proceeds of the book debts.
(note that the ability to draw the distinction between the debt and its proceeds is also in
question after Agnew).

• While the blocked account has been suggested by the Privy Council as one means of creating
the environment for an enforceable fixed charge, in commercial practice:
  - it is unlikely that financial institutions would be prepared to deal with debtors on this basis;
  - it could lead to the paralysis of the business of the debtor;
  - the degree of monitoring of accounts which would be required by the creditor would be
    onerous;
  - the chargee in exercising the level of control suggested by the Privy Council may run the
    risk of being found to be a shadow director and exposing itself to liability.

• Holders of floating charges may face some uncertainty in an insolvency context, whereby
employees and other nominated unsecured creditors are given priority under the law to assets
of an insolvent company. Note also the recently proposed amendments to the law regarding
employee entitlements in an insolvency context.

• Banks should review their existing charge documents.

• Administrators, receivers and liquidators should obtain legal advice on the effect of individual
charges.

If the chargee has (and exercises) the power of an owner, the charge will be fixed. If the
chargor is permitted to continue to act as the owner, it will probably be a floating charge.

A fixed chargee cannot have its cake, while allowing the chargor to eat it!