

**(1) Richard Dale Agnew and
(2) Kevin James Bearsley**

Appellants

v.

**(1) The Commissioner of Inland Revenue and
(2) Official Assignee for the estate in bankruptcy of Bruce
William Birtwhistle and Mark Leslie Birtwhistle**

Respondents

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL
COMMITTEE OF THE PRIVY COUNCIL,

Delivered the 5th June 2001

Present at the hearing:-

Lord Bingham of Cornhill
Lord Nicholls of Birkenhead
Lord Hoffmann
Lord Hobhouse of Woodborough
Lord Millett

*[Delivered by **Lord Millett**]*

1. The question in this appeal is whether a charge over the uncollected book debts of a company which leaves the company free to collect them and use the proceeds in the ordinary course of its business is a fixed charge or a floating charge.

2. The company which granted the charge in question, Brumark Investments Limited, is in receivership. The only assets available for distribution to creditors are the proceeds of the book debts which were outstanding when the receivers were appointed and which they have since collected. If the charge is a fixed charge, as the receivers contend, the proceeds are payable to the company's bank Westpac Banking Corporation as the holder of the charge. If, however, it was a floating charge at the time it was created then, by the combined effect of the Seventh Schedule to the Companies Act 1993 and section 30 of the Receiverships Act 1993, they are

payable to the employees and the Commissioner of Inland Revenue as preferential creditors. In a carefully reasoned judgment the judge (Fisher J) held that it was a fixed charge, but his decision was reversed by the Court of Appeal. A curiosity of the case is that the distinction between fixed and floating charges, which is of great commercial importance in the United Kingdom, seems likely to disappear from the law of New Zealand when the Personal Property Act 1999 comes into force.

3. The debenture is dated 9th August 1995. It is closely modelled on the instrument which was the subject of the controversial decision of the English Court of Appeal in *In re New Bullas Trading Ltd* [1994] 1 BCLC 449 and may have been deliberately drafted in order to take advantage of that decision. The relevant provisions of the debenture are set out in full in the judgments below and their Lordships can state them shortly. It is expressed to create a fixed charge on the book debts of the company which arise in the ordinary course of trading and their proceeds, but not those proceeds which are received by the company before the charge holder requires them to be paid into an account with itself (which it could do at any time but never did) or the charge created by the deed crystallises or is enforced whichever should first occur. Subject thereto, the charge is expressed to be a floating charge as regards other assets of the company. The debenture prohibits the company from disposing of its uncollected book debts, but permits it to deal freely in the ordinary course of its business with assets which are merely subject to the floating charge; these include the money in its bank accounts and the proceeds of the book debts when collected.

4. Thus the deed purports to create a fixed charge on the book debts which were outstanding when the receivers were appointed and the proceeds of the debts which they collected. Prior to their appointment, however, the company was free to collect the book debts and deal with the proceeds in the ordinary course of its business, though it was unable to assign or factor them. The question is whether the company's right to collect the debts and deal with their proceeds free from the security means that the charge on the uncollected debts, though described in the debenture as fixed, was nevertheless a floating charge until it crystallised by the appointment of the receivers. This is a question of characterisation. To answer it their Lordships must examine the nature of a floating charge and ascertain the features which distinguish it from a fixed charge. They propose to start by tracing the history of the floating

charge from its inception to the present day, paying particular attention to charges over book debts.

5. The floating charge originated in England in a series of cases in the Chancery Division in the 1870's: *In re Panama, New Zealand, and Australian Royal Mail Co* (1870) 5 Ch App 318 (generally regarded as the first case in which the floating charge was recognised); *In re Florence Land and Public Works Co, Ex p. Moor* (1878) 10 Ch D 530; *In re Hamilton's Windsor Ironworks Co., Ex p. Pitman & Edwards* (1879) 12 Ch D 707; and *In re Colonial Trusts Corporation, Ex p. Bradshaw* (1879) 15 Ch D 465. Two things led to this development. First, the possibility of assigning future property in equity was confirmed in *Holroyd v Marshall* (1862) 10 HL Cas 191. The principle was of general application and made it possible for future book debts to be assigned by way of security: *Tailby v Official Receiver* (1888) 13 App Cas 523. Secondly, the Companies Clauses Consolidation Act 1845 sanctioned a form of mortgage for use by statutory companies by which the company assigned "its undertaking". It was natural that this formula should afterwards be adopted by companies incorporated under the Companies Act 1862.

6. The debenture in *In re Panama, New Zealand, and Australian Royal Mail Co.* was in this form. It charged "the undertaking" of the company "and all sums of money arising therefrom". This was taken to mean all the assets of the company both present and future including its circulating assets, that is to say, assets which are regularly turned over in the course of trade. From the word "undertaking" Giffard LJ derived the inference that unless and until the charge holder intervened the parties contemplated that the company was to be at liberty to carry on business as freely as if the charge did not exist, which it would not be able to do if the circulating assets were subject to a fixed charge.

7. The thinking behind the development of the floating charge was that compliance with the terms of a fixed charge on the company's circulating capital would paralyse its business. This theme was repeated in many of the cases: see for example *In re Florence Land and Public Works Co.* at p. 541 *per* Sir George Jessel MR; *Biggerstaff v Rowatt's Wharf Ltd.* [1896] 2 Ch 93, at p.101 *per* Lindley LJ and p. 103 *per* Lopes LJ. A fixed charge gives the holder of the charge an immediate proprietary interest in the assets subject to the charge which binds all those into whose hands the assets may come with notice of the charge. Unless it

obtained the consent of the holder of the charge, therefore, the company would be unable to deal with its assets without committing a breach of the terms of the charge. It could not give its customers a good title to the goods it sold to them, or make any use of the money they paid for the goods. It could not use such money or the money in its bank account to buy more goods or meet its other commitments. It could not use borrowed money either, not even, as Sir George Jessel MR observed, the money advanced to it by the charge holder. In short, a fixed charge would deprive the company of access to its cash flow, which is the life blood of a business. Where, therefore, the parties contemplated that the company would continue to carry on business despite the existence of the charge, they must be taken to have agreed on a form of charge which did not possess the ordinary incidents of a fixed charge.

8. The floating charge is capable of affording the creditor, by a single instrument, an effective and comprehensive security upon the entire undertaking of the debtor company and its assets from time to time, while at the same time leaving the company free to deal with its assets and pay its trade creditors in the ordinary course of business without reference to the holder of the charge. Such a form of security is particularly attractive to banks, and it rapidly acquired an importance in English commercial life which the Insolvency Law Review Committee (1982 Cmnd. 8558 at para. 1525) later considered should not be underestimated. It was, however, not available to individual traders because of the doctrine of reputed ownership in bankruptcy. That doctrine did not apply to companies. It was abolished in England by the Insolvency Acts 1985-6 following a recommendation of the Insolvency Law Review Committee. It had already been abolished in New Zealand by Section 42 of the Insolvency Act 1967.

9. Valuable as the new form of security was, it was not without its critics. One of its consequences was that it enabled the holder of the charge to withdraw all or most of the assets of an insolvent company from the scope of a liquidation and leave the liquidator with little more than an empty shell and unable to pay preferential creditors. Provision for the preferential payment of certain classes of debts had been introduced in bankruptcy in 1825 and was extended to the winding up of companies by section 1(1)(g) of the Preferential Payments in Bankruptcy Act 1888. Section 107 of the Preferential Payments in Bankruptcy Amendment Act 1897 now made the preferential debts payable out of the proceeds of a floating charge in priority to the debt secured by the charge.

10. A second mischief arose from the very nature of the floating charge which allowed a company to continue to trade and incur credit despite the existence of the charge. This put the ordinary trade creditors of the company at risk, even though they would not normally know of the existence of the charge; for the holder of the charge could step in without warning at any time and obtain priority over them. Such trade creditors would include the suppliers of goods which the charge holder could appropriate to the security and realise for its own benefit leaving the suppliers unpaid. This was seen by many judges as an injustice and by Lord Macnaghten as a great scandal: see *In re General South American Co.* (1876) 2 Ch D 337 at 341 *per* Malins V-C; *Salomon v Salomon* [1897] AC 22 at p. 53 *per* Lord Macnaghten; *In re London Pressed Hinge Co. Ltd.* [1905] 1 Ch 576, at pp. 581, 583 *per* Buckley J. Lord Macnaghten proposed giving the ordinary trade creditors a preferential claim on the assets of an insolvent company in respect of debts incurred within a limited time before the winding-up. More than 80 years later a recommendation along not dissimilar lines was made by the Insolvency Law Reform Committee. Neither was implemented. The remedy adopted by Parliament was to require floating charges to be registered so that those proposing to extend credit to a company could discover their existence. The requirement was introduced (in England) by section 14 of the Companies Act 1900 and (in New Zealand) by section 130 of the Companies Act 1903. It was extended (in England) by section 10(1)(e) of the Companies Act 1907 and (in New Zealand) by section 89(2)(f) of the Companies Act 1933 to include all charges on book debts whether floating or fixed. The thinking behind this was presumably that debts subject to a fixed charge are still shown as assets in the company's balance sheet as "debtors" and thus appear to be available to support the company's credit. So far as the ordinary trade creditors were concerned, however, the remedy provided by registration was more theoretical than real.

11. Before the introduction of this legislation the expression "floating charge", though in common use, had no distinct meaning.

It was not a legal term or term of art. Now, however, it became necessary to distinguish between fixed charges and charges which were floating charges within the meaning of the Acts. Lord Macnaghten essayed the first judicial definition in *Governments Stock and Other Securities Investment Co Ltd v Manila Railway Co.* [1897] AC 81, at p. 86:

"A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject

charged in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes.”

The concept of a proprietary interest in a fluctuating fund of assets was, of course, very familiar to Chancery judges. The similarity between the position of the holder of a floating charge and that of the beneficiaries of a trust fund has been noted by Professor Goode: see *Legal Problems of Credit and Security* (1988) pp. 48-51.

12. The most celebrated, and certainly the most often cited, description of a floating charge is that given by Romer LJ in *In re Yorkshire Woolcombers Association Ltd.* [1903] 2 Ch D 284 at p. 295:

“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 that I am about to mention, but 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 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 I am dealing with.”

13. This was offered as a description and not a definition. The first two characteristics are typical of a floating charge but they are not distinctive of it, since they are not necessarily inconsistent with a fixed charge. It is the third characteristic which is the hallmark of a floating charge and serves to distinguish it from a fixed charge. Since the existence of a fixed charge would make it impossible for the company to carry on business in the ordinary way without the consent of the charge holder, it follows that its ability to do so without such consent is inconsistent with the fixed nature of the charge. In the same case Vaughan Williams LJ explained at p. 294:

“... but what 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. If at the will of the mortgagor he can dispose of it and prevent its being any longer a security, although something else may be substituted more or less for it, that is not a "specific security"* (emphasis added).

14. This was the first case to deal specifically with book debts. The question was whether a charge on uncollected book debts was a fixed charge or a floating charge so as to require registration. At every level of decision it was held to be a floating charge, the critical factor being the company's freedom to receive the book debts for its own account and deal with the proceeds without reference to the charge holder. At first instance Farwell J said at p. 288:

"If the assignment is to be treated as a specific mortgage or charge or disposition, then the company had no business to receive one single book debt after the date of it; but if, on the other hand, although not so called, *the company was intended to go on receiving the book debts and to use them for the purpose of carrying on its business*, then it contains the true elements of a floating security" (emphasis added).

And at p. 289:

"A charge on all book debts which may now be, or at any time hereafter become charged or assigned, leaving the mortgagor or assignor free to deal with them as he pleases until the mortgagee or assignee intervenes, is not a specific charge, and cannot be. The very essence of a specific charge is that the assignee takes possession, and is the person entitled to receive the book debts at once. So long as he licenses the mortgagor *to go on receiving the book debts and carry on the business*, it is within the exact definition of a floating security" (emphasis added).

Romer LJ at p. 296 and Cozens-Hardy LJ at p. 297 spoke in similar vein in the Court of Appeal, both expressly treating the company's right to go on *receiving* the book debts as inconsistent with the nature of a fixed charge.

15. When the case reached the House of Lords *sub. nom. Illingworth v Houldsworth* [1904] AC 355 Lord Halsbury LC also took this to be the critical factor at p. 357:

"It contemplates not only that it should carry with it the book debts which were then existing, but it contemplates also the

possibility of *those book debts being extinguished by payment to the company, and that other book debts should come in and take the place of those that had disappeared.* That, my Lords, seems to me to be an essential characteristic of what is properly called a floating security. The recitals ... shew an intention on the part of both parties that the business of the company shall continue to be carried on in the ordinary way - that the book debts shall be at the command of, and for the purpose of being used by, the company. Of course, if there was an absolute assignment of them which fixed the property in them, the company would have no right to touch them at all. The minute after the execution of such an assignment they would have no more interest in them, and would not be allowed to touch them, whereas as a matter of fact it seems to me that the whole purport of this instrument is to enable the company to carry on its business in the ordinary way, *to receive the book debts that were due to them*, to incur new debts, and to carry on their business exactly as if this deed had not been executed at all. That is what we mean by a floating security.” (emphasis added).

16. The jurisprudential nature of the floating charge was analysed by Buckley LJ in *Evans v Rival Granite Quarries Ltd.* [1910] 2 KB 979. By now it was evident that the classification of a security as a floating charge was a matter of substance and not merely a matter of drafting. As Fletcher Moulton LJ observed in that case at p. 993:

“But at an early period it became clear to judges that this conclusion did not depend upon the special language used in the particular document, but upon the essence and nature of a security of this kind.”

17. The law was settled to this effect for the next 70 years. By the 1970's, however, the banks had become disillusioned with the floating charge. The growth in the extent and amount of the preferential debts, due in part to increases in taxation and in part to higher wages and greater financial obligations to employees, led banks to explore ways of extending the scope of their fixed charges. It had always been possible to take a fixed charge over specified debts. There were two ways of doing this. A lender could take an assignment of each debt and perfect the security by giving notice to the debtor, thereby constituting the assignment a legal assignment and entitling the assignee to collect the debt itself. The debtor, having received notice of the assignment, would not obtain a good discharge by paying the assignor. But this method of dealing with a large number of book debts was commercially

impractical. A bank or other financial institution is unlikely to be in a position to maintain credit control over the debts from time to time owing to its customer or to want to collect the debts itself; while giving notice to the debtors would seriously harm its customer's credit. The method commonly adopted, therefore, was for the lender to take an assignment of the debts but refrain from giving notice to the debtors until the assignor was in default. This meant that the assignment was an equitable assignment only, and debtors who paid the assignor without notice of the assignment would obtain a good discharge. In order to entitle the assignor to collect the debts, the assignee gave it authority to collect the debts on the assignee's behalf. The instrument of charge would constitute the assignor a trustee of the proceeds for the assignee and require it to account to the assignee for them.

18. There was never any doubt that the second of these two methods, like the first, was effective to create a fixed charge on the book debts. The fact that the assignor was free to collect the book debts was not inconsistent with the fixed nature of the charge, because the assignor was not collecting them for its own benefit but for the account of the assignee. The proceeds were not available to the assignor free from the security but remained under the control of the assignee.

19. It was, however, generally considered that it was not possible to take a fixed charge over a fluctuating class of present and future book debts. There were two reasons for this. One was commercial: book debts are part of the circulating capital of a business and constitute an important source of its cash flow, which makes it difficult to subject them to a fixed charge without paralysing the business. The other was conceptual. It is a characteristic of a floating charge that it is a charge on fluctuating assets, and it was assumed that a charge on fluctuating assets must therefore be a floating charge. The fallacy in this reasoning was exposed by Slade J in *Siebe Gorman & Co. Ltd. v Barclays Bank Ltd.* [1979] 2 Lloyd's Rep 142.

20. The case was concerned with the proceeds of book debts in the form of bills of exchange which were held for collection when the receivers were appointed. The company had purported to grant its bank a fixed charge on its book debts and a floating charge on other assets. The company was prohibited from disposing of the uncollected debts, and although it was free to collect them it was required to pay the proceeds into an account in its name with the bank. Slade J held that the critical feature which distinguished a

floating charge from a fixed charge was not the fluctuating character of the charged assets but the company's power to deal with them in the ordinary course of business. He found that, on the proper construction of the debenture, the company was not free to draw on the account without the consent of the bank even when it was in credit. Accordingly, he held that the charge on the uncollected book debts and their proceeds was a fixed charge.

21. The debenture placed no express restrictions on the company's right to draw on the account, which was the company's ordinary business account, and the judge's finding in this respect has been doubted. But it was critical to his decision that the charge on the book debts was a fixed charge. He said at p. 158:

“... if I had accepted the premise that [the company] would have had the unrestricted right to deal with the proceeds of any 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.”

22. The decision was followed by the Supreme Court of Ireland in *Re Keenan Bros. Ltd.* [1986] BCLC 242 where the company purported to grant its bank fixed charges over its present and future book debts. The debenture prohibited the company from disposing of the book debts or creating other charges over them without the consent of the bank. It allowed the company to collect the book debts, but required it to pay the proceeds into a designated account with the bank from which the company was not to make any withdrawals without the written consent of the bank. In holding the charge to be a fixed charge, McCarthy J presciently observed at p. 247 that:

“It is not suggested that mere terminology itself, such as using the expression ‘fixed charge’, achieves the purpose; one must look, not within the narrow confines of such term, not to the declared intentions of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention ...”

The critical feature which led the Court to characterise the charge on the book debts as a fixed charge was that their proceeds were to be segregated in a blocked account where they would be frozen and rendered unusable by the company without the bank's written consent. As Henchy J explained at p. 246:

“It seems to me that such a degree of sequestration of the book debts when collected made those moneys incapable of being used in the ordinary course of business and meant that they were put, specifically and expressly, at the disposal of the bank. I am satisfied that assets thus withdrawn from ordinary trade use, put in the keeping of the debenture holder, and sterilised and made undisposable save at the absolute discretion of the debenture holder, have the distinguishing feature of a fixed charge. The charge was not intended to float in the future on the book debts; *it was affixed forthwith and without further ado to those debts as they were collected ...* (emphasis added).

23. These cases were followed by a number of cases on the other side of the line. An Australian case was *Hart v Barnes* (1982) 7 ACLR 310, where the debenture purported to create a fixed charge on the company's future book debts, but the parties entered into a collateral agreement of the same date which allowed the company to collect the book debts and use the proceeds in its business as it saw fit. Anderson J held that the charge was a floating charge. The debenture holder could not sensibly be said to have obtained a proprietary interest by way of a fixed charge when its interest was

“defeasible and capable of being destroyed by the company which is able to use the proceeds of such book debt in its business without in any way being accountable to the debenture holder for such proceeds.

This is the other side of the coin. If the chargor is free to deal with the charged assets and so withdraw them from the ambit of the charge without the consent of the chargee, then the charge is a floating charge. But the test can equally well be expressed from the chargee's point of view. If the charged assets are not under its control so that it can prevent their dissipation without its consent, then the charge cannot be a fixed charge.

24. An English decision was *In re Brightlife Ltd.* [1987] Ch 200. The company purported to grant its bank a fixed charge over its book debts both present and future and a floating charge over other assets. The company was not permitted to sell, factor or discount debts without the bank's written consent, but it was free to collect the debts and pay them into its ordinary bank account, though it was not required to do so. The case was thus distinguishable from but very similar to *Siebe Gorman* save that it was concerned with the proceeds of book debts which were still uncollected when the receivers were appointed. Hoffmann J held that, although the

charge was expressed to be a fixed charge, it should be characterised in law as a floating charge. As he explained at p. 209:

“In this debenture, the significant feature is that [the company] was free to collect its debts and pay the proceeds into its bank account. Once in the account, they would be outside the charge over debts and at the free disposal of the company. In my judgment a right to deal in this way with the charged assets for its own account is a badge of a floating charge and is inconsistent with a fixed charge.”

25. In New Zealand there was *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd.* [1994] 3 NZLR 300, where the facts were indistinguishable from those in *Siebe Gorman*. Tompkins J held that the charge was a floating charge. He held (following Hoffmann J in *Brightlife*) that a restriction on charging or assigning the debts was not sufficient by itself to create a fixed charge, and (not following Slade J in *Siebe Gorman*) that a requirement to pay the proceeds into the company’s account with the holder of the charge without any restriction on the company’s power to use the money in the account was insufficient to do so either.

26. *Brightlife* was followed in *In re Cosslett (Contractors) Ltd.* [1998] Ch 495, in a different context. It was concerned with the nature of a charge over plant and machinery on a building site which the chargor was free to remove from the site but only if they were not required for the completion of the works. At p. 510 Millett LJ said:

“The chargor's unfettered freedom to deal with the assets in the ordinary course of his business free from the charge is obviously inconsistent with the nature of a fixed charge; but it does not follow that his unfettered freedom to deal with the charged assets is essential to the existence of a floating charge. It plainly is not, for any well drawn floating charge prohibits the chargor from creating further charges having priority to the floating charge; and a prohibition against factoring debts is not sufficient to convert what would otherwise be a floating charge on book debts into a fixed charge: see in *In re Brightlife Ltd.* [1987] Ch 200, 209, *per Hoffmann J.*

The essence of a floating charge is that it is a charge, not on any particular asset, but on a fluctuating body of assets which remain under the management and control of the chargor, and which the chargor has the right to withdraw

from the security despite the existence of the charge. The essence of a fixed charge is that the charge is on a particular asset or class of assets which the chargor cannot deal with free from the charge without the consent of the chargee. The question is not whether the chargor has complete freedom to carry on his business as he chooses, but whether the chargee is in control of the charged assets.”

27. The need for a requirement that the company should pay the proceeds of its book debts into the bank account which the company maintained with the holder of the charge did not cause any problem for the banks or their customers. That is what the company would normally do even in the absence of such a requirement. But the banks did not want to monitor the bank account and be required to give their consent whenever the company wished to make a withdrawal. They wanted the best of both worlds. They wanted to have a fixed charge on the book debts while allowing the company the same freedom to use the proceeds that it would have if the charge were a floating charge. With this object in view the draftsman of the charge which came before the court in *New Bullas* adopted a new approach.

28. In every previous case the debenture had treated book debts and their proceeds indivisibly. Now for the first time in any reported case the draftsman set out deliberately to distinguish between them. As in the present case the debenture purported to create two distinct charges, a fixed charge on the book debts while they remained uncollected and a floating charge on their proceeds. It differed from the debenture in the present case only in that the proceeds of the debts were not released from the fixed charge until they were actually paid into the company’s bank account, whereas in the present case they were released from the fixed charge as soon as they were received by the company. Their Lordships attach no significance to this distinction. The intended effect of the debenture was the same in each case. Until the charge holder intervened the company could continue to collect the debts, though not to assign or factor them, and the debts once collected would cease to exist. The proceeds which took their place would be a different asset which had never been subject to the fixed charge and would from the outset be subject to the floating charge.

29. The question in *New Bullas*, as in the present case, was whether the book debts which were uncollected when the receivers were appointed were subject to a fixed charge or a floating charge. At first instance Knox J, following *Brightlife*, held that they were

subject to a floating charge. His decision was reversed by the Court of Appeal. Nourse LJ gave the only judgment.

30. He began by observing that, there being usually no need to deal with a book debt before collection, an uncollected book debt is a natural subject of a fixed charge; but once collected, the proceeds being needed for the conduct of the business, it becomes a natural subject of a floating charge. Their Lordships regard this as unsound: one might equally well say that unsold trading stock is a suitable subject of a fixed charge. Trading stock, that is to say goods held for sale and delivery to customers, and book debts, that is to say debts owed by customers to whom goods have been supplied or services rendered, are equally part of a trader's circulating capital. The trader does not hold them for enjoyment in specie. They provide him with his cash flow and as such are the natural subjects of a floating charge. His ability to carry on business depends upon his freedom to realise such assets by turning them into money and back again.

31. The principal theme of the judgment, however, was that the parties were free to make whatever agreement they liked. The question was therefore simply one of construction; unless unlawful the intention of the parties, to be gathered from the terms of the debenture, must prevail. It was clear from the descriptions which the parties attached to the charges that they had intended to create a fixed charge over the book debts while they were uncollected and a floating charge over the proceeds. It was open to the parties to do so, and freedom of contract prevailed.

32. Their Lordships consider this approach to be fundamentally mistaken. The question is not merely one of construction. In deciding whether a charge is a fixed charge or a floating charge, the Court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they have used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the Court can then embark on the second stage of the process, which is one of categorisation. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument, is to grant the company rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge

cannot be a fixed charge however they may have chosen to describe it. A similar process is involved in construing a document to see whether it creates a licence or tenancy. The Court must construe the grant to ascertain the intention of the parties: but the only intention which is relevant is the intention to grant exclusive possession: see *Street v Mountford* [1985] AC 809 at p. 826 *per* Lord Templeman. So here: in construing a debenture to see whether it creates a fixed or a floating charge, the only intention which is relevant is the intention that the company should be free to deal with the charged assets and withdraw them from the security without the consent of the holder of the charge; or, to put the question another way, whether the charged assets were intended to be under the control of the company or of the charge holder.

33. In *New Bullas* the preferential creditors argued that the charge was a floating charge because the company was indeed free to withdraw the book debts from the security, which it could do simply by collecting them and using the proceeds in the ordinary course of its business. Nourse LJ rejected this, holding that it was not correct to say that the book debts could cease to be subject to the fixed charge at the will of the company; they ceased to be subject to the fixed charge because that is what the parties had agreed in advance when they entered into the debenture.

34. Their Lordships agree with Fisher J in the present case that this reasoning cannot be supported. 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.

35. The decision has attracted much academic comment, much (though not all) of it hostile. Most interest, perhaps not surprisingly, has been generated by the novel attempt to separate the book debts from their proceeds: see for example Professor Goode: "*Charges over Book Debts: A Missed Opportunity*" (1994) 110 LQR 592; Sarah Worthington: "*Fixed Charges over Book Debts and other Receivables*" (1997) 113 LQR 562; Berg *per contra*: "*Charges over Book Debts: A Reply*" [1995] JBL 443. Their Lordships will return to this aspect after they have examined the other reasons given by Fisher J for following *New Bullas* in the present case.

36. The judge considered that the critical distinction between a floating charge and a fixed charge lay in the presence or absence of a power on the part of the company to dispose of the charged assets to third parties. It was sufficient to create a fixed charge on book debts that the company should be prohibited from alienating them, whether by assigning, factoring or charging them. It was not necessary to go further and also prohibit the company from collecting them and disposing of the proceeds. Their Lordships cannot accept this. It is contrary to both principle and authority and their Lordships think to commercial sense. It is inconsistent with the actual decisions in *Brightlife* and *Supercool* and contrary to the statements of principle in virtually every case from *Re Yorkshire Woolcombers Association Ltd.* to *Cosslett*. It makes no commercial sense because alienation and collection are merely different methods of realising a debt by turning it into money, collection being the natural and ordinary method of doing so. A restriction on disposition which nevertheless allows collection and free use of the proceeds is inconsistent with the fixed nature of the charge; it allows the debt and its proceeds to be withdrawn from the security by the act of the company in collecting it.

37. The judge drew a distinction between a power of disposition and a power of consumption. There is nothing, he suggested, inconsistent with a fixed charge in prohibiting the company from disposing of the charged asset to others but allowing it to exploit the characteristics inherent in the nature of the asset itself. Their Lordships agree with this, so long as the destruction of the security is due to a characteristic of the subject matter of the charge and not merely to the way in which the charge is drafted. A fixed charge may be granted over a wasting asset. A short lease, for example, is not particularly good security, but there is no conceptual difficulty in making it subject to a fixed charge. It will cease to exist by effluxion of time, but while it subsists it cannot be destroyed or withdrawn from the security by any act of the chargor. The chargee can protect itself by arranging appropriate terms of repayment so that the amount of the debt which is outstanding at any one time is commensurate with the value of the remaining security.

38. The judge gave two examples of fixed charges over assets which are defeasible at the will of the chargor. One was a charge over uncalled share capital; the other was a shipowner's lien on subfreights. With respect neither supports his argument. A charge on uncalled share capital leaves the company with the right to make calls, and this may properly be regarded as analogous to a right to

collect book debts. But, as the Court of Appeal observed, such a charge is normally accompanied by restrictions on the use to which the company may put the receipts, so that the situation is analogous to that which was thought to obtain in *Siebe Gorman* and did obtain in *In re Keenan*. The company can collect the money, but it is not free to use it as it sees fit.

39. The common form provision in a charterparty that the ship owner has a lien on subfreights is a different matter. In England it has been held to be a registrable charge either as a charge on book debts whether fixed or floating (*In re Welsh Irish Ferries Ltd.* [1986] Ch 471; *Itex Itagrani Export SA v Care Shipping Corp.* [1990] 2 Lloyd's Rep 316) or as a floating charge (*Annangel Glory Compania Naviera SA v M Golodetz Ltd.* [1988] 1 Lloyd's Rep 45). In none of these cases was it held to be a fixed charge, but the better view is that it is not a charge at all: see Oditha "*The Juridical Nature of a Lien on Subfreights*" (1989) LMCLQ. 191.

40. The extent of the rights conferred by the lien was described by Lord Alverstone in *Tagart, Beaton & Co. v James Fisher & Sons* [1903] 1 KB 391 at p. 395:

"A lien such as this on a sub-freight means a right to receive it as freight and to stop that freight at any time before it has been paid to the time charterer or his agent; but such a lien does not confer the right to follow the money paid for freight into the pockets of the person receiving it simply because that money has been received in respect of a debt which was due for freight."

41. The lien is the creation of neither the common law nor equity. It originates in the maritime law, having been developed from the ship owner's lien on the cargo. It is a contractual non-possessory right of a kind which is *sui generis*. Since the subfreights are book debts and so incapable of physical possession, the lien has been described as an equitable charge: see *The Nanfri* [1979] AC 757 at p. 784 *per* Lord Russell of Killowen. But this was a passing remark which was not necessary to the decision, and if the lien is a charge it is a charge of a kind unknown to equity. An equitable charge confers a proprietary interest by way of security. It is of the essence of a proprietary right that it is capable of binding third parties into whose hands the property may come. But the lien on subfreights does not bind third parties. It is merely a personal right to intercept freight before it is paid analogous to a right of stoppage *in transitu*. It is defeasible on payment irrespective of the identity of the recipient. In this respect it is similar to a floating charge while it floats, but it differs in that it is incapable of crystallisation. The

ship owner is unable to enforce the lien against the recipient of the subfreights but, as Oditah observes, this is not because payment is the event which defeats it as Nourse J stated in *In re Welsh Irish Ferries Ltd.*; it is because the right to enforce the lien against third parties depends on an underlying property right, and this the lien does not give. Apart from the obiter dictum of Lord Russell in *The Nanfri*, the cases in which the lien has been characterised as an equitable charge are all decisions at first instance and none of them contains any analysis of the requirements of a proprietary interest. Quite apart from the conceptual difficulties in characterising the lien as a charge, the adverse commercial consequences of doing so are sufficiently serious to cast grave doubt on its correctness. In passing from this topic their Lordships note that the decision in *In re Welsh Irish Ferries Ltd.* will be reversed by Parliament by section 396(2)(g) of the Companies Act 1985 inserted by section 93 of the Companies Act 1989 when that section is brought into force.

42. Their Lordships turn finally to the questions which have exercised academic commentators: whether a debt or other receivable can be separated from its proceeds; whether they represent a single security interest or two; and whether a charge on book debts necessarily takes effect as a single indivisible charge on the debts and their proceeds irrespective of the way in which it may be drafted.

43. Property and its proceeds are clearly different assets. On a sale of goods the seller exchanges one asset for another. Both assets continue to exist, the goods in the hands of the buyer and proceeds of sale in the hands of the seller. If a book debt is assigned, the debt is transferred to the assignee in exchange for money paid to the assignor. The seller's former property right in the subject matter of the sale give him an equivalent property right in its exchange product. The only difference between realising a debt by assignment and collection is that, on collection, the debt is wholly extinguished. As in the case of alienation, it is replaced in the hands of the creditor by a different asset, viz. its proceeds.

44. The Court of Appeal saw no reason to examine the conceptual problems further. They held that, even if a debt and its proceeds are two different assets, the company was free to realise the uncollected debts, and accordingly the charge on those assets (being the assets whose destination was in dispute) could not be a fixed charge. There was simply no need to look at the proceeds at all. The same point is neatly expressed in Lightman and Moss: *The Law of Receivers of Companies* (2nd Ed. 1994) at p. 36:

“If there is a valid legal distinction to be drawn between a debt and its proceeds, then one might have thought that the two should be treated as separate assets of the company, ie. that the debt exists while uncollected and is extinguished by payment, at which point the company acquires a new asset, namely the moneys paid by the debtor. If this is right, then it is difficult to see why an agreement relating to dealings with one asset, namely the moneys received, should be at all relevant to the validity of the charge which existed over a different asset, namely the debt while it was uncollected.”

45. Their Lordships agree with this to this extent: if the company is free to collect the debts, the nature of the charge on the uncollected debts cannot differ according to whether the proceeds are subject to a floating charge or are not subject to any charge. In each case the commercial effect is the same: the charge holder cannot prevent the company from collecting the debts and having the free use of the proceeds. But it does not follow that the nature of the charge on the uncollected book debts may not differ according to whether the proceeds are subject to a fixed charge or a floating charge; for in the one case the charge holder can prevent the company from having the use of the proceeds and in the other it cannot. The question is not whether the company is free to collect the uncollected debts, but whether it is free to do so for its own benefit. For this purpose it is necessary to consider what it may do with the proceeds.

46. While a debt and its proceeds are two separate assets, however, the latter are merely the traceable proceeds of the former and represent its entire value. A debt is a receivable; it is merely a right to receive payment from the debtor. Such a right cannot be enjoyed in specie; its value can be exploited only by exercising the right or by assigning it for value to a third party. 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 their proceeds (even if conceptually possible) makes no commercial sense.

47. The draftsman of the debenture in the present case recognised this. He purported to separate the book debts and their proceeds, but he did not attempt to separate their ownership. They were charged by the same chargor to the same chargee. It is a matter of personal choice whether one describes this as resulting in two different charges or a single charge (which is said to be convertible). The critical factor which is determinative of the nature

of the charge in respect of the uncollected book debts is that the event which is said to convert the charge from a fixed to a floating charge (if there is only one) or to replace the one charge by the other (if there are two) is the act of the company.

48. To constitute a charge on book debts a fixed charge, it is sufficient to prohibit the company from realising the debts itself, whether by assignment or collection. If the company seeks permission to do so in respect of a particular debt, the charge holder can refuse permission or grant permission on terms, and can thus direct the application of the proceeds. But it is not necessary to go this far. As their Lordships have already noted, it is not inconsistent with the fixed nature of a charge on book debts for the holder of the charge to appoint the company its agent to collect the debts for its account and on its behalf. *Siebe Gorman* and *Re Keenan* merely introduced an alternative mechanism for appropriating the proceeds to the security. The proceeds of the debts collected by the company were no longer to be trust moneys but they were required to be paid into a blocked account with the charge holder. The commercial effect was the same: the proceeds were not at the company's disposal. Such an arrangement is inconsistent with the charge being a floating charge, since the debts are not available to the company as a source of its cash flow. But their Lordships would wish to make it clear 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.

49. Before their Lordships the receivers insisted that the company had no power to withdraw either the book debts or their proceeds from the security of the fixed charge. The debenture was so drafted that the company had no need to do so. The debts were automatically extinguished by collection and their proceeds never became subject to a fixed charge. But this is simply playing with words. Whether conceptually there was one charge or two, the debenture was so drafted that the company was at liberty to turn the uncollected book debts to account by its own act. Taking the relevant assets to be the uncollected book debts, the company was left in control of the process by which the charged assets were extinguished and replaced by different assets which were not the subject of a fixed charge and were at the free disposal of the company. That is inconsistent with the nature of a fixed charge.

50. Their Lordships consider that *New Bullas* was wrongly decided. They will humbly advise Her Majesty that the present

appeal should be dismissed. The appellants must pay the respondents' costs before the Board.

