



## Fixed charges over book debts: Have the rules changed?

*The House of Lords has unanimously held in National Westminster Bank plc v Spectrum Plus Limited that a charge over book debts, where the chargor maintains freedom to use the deposited proceeds of the book debts in the ordinary course of its business, is a floating charge as opposed to a fixed charge.*

### Key message

*The decision sends a message to the banking and finance industry that **chargees may need to control the receipt and disposal of proceeds of book debts** to have an effective fixed charge over the book debts.*

This much anticipated decision brings to an end years of controversy regarding the categorisation of charges over book debts... in the UK at least. The decision sends a clear message that chargees must control the receipt and disposal of proceeds of book debts, to be certain they have an effective fixed charge over book debts, in the UK.

To chargees, the categorisation of book debts as a fixed or floating charge can make all the difference when chargors face insolvency. This is because on realisation of assets, fixed charge holders have priority over preferential creditors (such as employees), while floating charge holders lose priority to preferential creditors.

The banking and finance industry had relied for more than 25 years on the first instance (Chancery Division) decision in *Siebe Gorman & Co Ltd v Barclays Bank Ltd*. In that case it was held that a debenture, which prohibited the disposition of book debts prior to collection and required the proceeds to be paid into a nominated bank account on collection, was sufficient to constitute a fixed charge. The charge was considered fixed even though the chargor may have been allowed to deal with the proceeds of the book debts without the chargee's consent.

*Spectrum Plus* was an opportunity for the House of Lords to review the *Siebe Gorman* decision. The brief facts of the case were that

*Spectrum Plus Ltd* ('Spectrum') obtained an overdraft facility of £250,000 from National Westminster Bank Plc ('NatWest') using a debenture to secure the debt. The debenture expressly created a fixed charge over book debts owing to Spectrum, in similar terms to that in *Siebe Gorman*. The charge prohibited Spectrum from disposing of or encumbering uncollected book debts, and required Spectrum to pay the proceeds into its overdraft account with NatWest. However, Spectrum was free to draw on the overdraft account provided the overdraft limit was not exceeded.

Subsequently, Spectrum went into creditors' voluntary liquidation. NatWest sought a declaration that the charge over Spectrum's book debts was fixed, to gain priority over preferential creditors (mainly the Commissioners of Inland Revenue and other government departments). At first instance, it was held that the charge over book debts was floating and that *Siebe Gorman* was wrongly decided. On appeal, the *Siebe Gorman* decision was upheld and the Court of Appeal found there were sufficient restrictions imposed on the way Spectrum could deal with the book debts to constitute a fixed charge.

The House of Lords disagreed and held that for a charge over book debts to be fixed, the chargee must exercise *actual* control

over the account into which proceeds are deposited. Since Spectrum could draw proceeds from its account without the consent of NatWest, the House of Lords found there was insufficient control of the book debts and proceeds to consider the charge as fixed, even though NatWest could terminate or reduce the overdraft and demand repayment. That the account was with the chargee was immaterial to establishing the requisite control for a fixed charge.

## What relevance to charges in Australia?

» The only Australian case to have considered fixed charges over book debts is *Whitton v ACN 003 266 866 (in liq) (formerly Boswell Printing Pty Ltd)*, in which Dina Glass acted for the financier. This case followed the English decision of *In re New Bullas*, and remains current law in Australia. It held that a charge expressed to be fixed over book debts and floating over the proceeds, where the chargee has the right (without default) to control the proceeds whether actually exercised or not, is a fixed charge over the book debts. The Court recognised the intention of the parties as expressed in the charge agreement.

» The *Spectrum Plus* decision of the House of Lords held that the actual effect of the documents which purported to carry out the parties' intention had to be considered also. The House of Lords confirmed that the approach in *New Bullas* was incorrect. The decision is not binding in Australia, however, it will be persuasive to Courts in considering the two different approaches.

» The competing parties in *Spectrum Plus* were revenue authorities. Accordingly, the Court may have preferred their claims for policy reasons. The revenue authorities are not preferential creditors under Australian law. However, the Commonwealth Government through the General Employee Entitlements and Redundancy Scheme (GEERS), may take an active role in the future (for example, in setting aside a deed of company arrangement as in *Commonwealth of Australia v Rocklea Spinning Mills Pty Ltd*). Accordingly the Courts in Australia may, for public policy reasons, protect employee entitlements by preferring the approach in *Spectrum Plus*.

» Until the Australian courts consider the approach in *Spectrum Plus*, to achieve a fixed charge over book debts, prudent lenders should ensure that the actual effect of their finance documents and dealings is that borrowers cannot deal with book debts or their proceeds in the ordinary course of business, without the consent of the Chargee.

» A more comprehensive analysis of the case can be found on our website: [www.middletons.com.au](http://www.middletons.com.au)

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