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Article:

Sheehan, D. (2023) Identifying Floating Charges after Re Avanti Communications Ltd (in Administration). Butterworths Journal of International Banking and Financial Law, 38 (10).
ISSN: 0269-2694

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Identifying floating charges after *Re Avanti Communications Ltd* (in Administration)

(2023) 10 JIBFL 684

1 November 2023

Journal of International Banking & Financial Law > 2023 Volume 38 > Issue 10 > Articles



Journal of International Banking and Financial Law

Features

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*This article discusses the decision in *Re Avanti Communications Ltd* (in Administration) and how the criteria laid down in the case affect the characterisation of charges over different types of assets as being either fixed or floating.*

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KEY POINTS

- *Re Avanti Communications Ltd* [2023] EWHC 940 involved a reconsideration of the authority on the distinction between fixed and floating charges. It considers the extent to which the chargee must “control” the assets so that the chargor cannot remove them freely from the security.
- The extent to which a purported fixed charge can do this is subject to some discretion and it will be impossible to prescribe rules in advance. A total prohibition on dealings is not required for the charge to be fixed.
- Some tentative suggestions can, however, be made as to when a charge might be floating or fixed over different asset types, but further questions remain unexplored.

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THE FACTS AND DECISION OF RE AVANTI COMMUNICATIONS LTD

The principal activity of the group and of the company was the operation of satellites and the sale of broadband and satellite connectivity services and part of the assets under consideration (the relevant assets) involved satellite payloads, the so-called HYLAS 3 payload and associated ground equipment along with various satellite filings and licences. Those filings and licences were transferred by the company to another company in the group, AH2L – a sale for fair market value to which Ofcom consented (paras 6-14).

The company then granted a fixed charge over the so-called AH2 FVM payment obligations in favour of the secured creditors. A parallel loan instrument was also issued by AH2L to Avanti to enable it to meet the claims of preferential creditors and the prescribed part if the security over the relevant assets were re-characterised as floating. HMRC was the only preferential creditor (para 16) and would take priority if the charges were floating. Johnson J identified the 2017 debenture as the important one for interpretation as the terms of the 2013 debenture were substantially the same (para 22). The company was able to sell the relevant assets under various conditions. It had to – for example – receive consideration equal to the fair market value of the assets and receive consideration in cash or its equivalent (para 89). Once it had done so, unless the sale proceeds amounted to less than \$1m it had to comply with the so-called Waterfall provisions which rendered such disposals economically unattractive because, as Johnson J explained at para 124, the company could not use the proceeds for the benefit of its own business; rather they were to be applied to discharge the secured debts in the order of priority established by the debt facility documents and intercreditor agreements (para 73).

This reflects one of the ways in which Lord Hope suggested a fixed charge could be effectively taken in *NatWest v Spectrum Plus Ltd* [2005] UKHL 41 [54] namely that proceeds would be used to pay down the debt. If the sale fell into one of five exceptions, referred to as the Asset Sale Exceptions, it was not subject to these restrictions, however.

- (1) The Limited Value Exception (paras 91-93) allowed for equipment of low value to be sold, but the relevant assets were of too high a value to fit within the definition.
- (2) The Capacity Exception (paras 94-96) allowed members of the Group to make sales of satellite capacity and related services. Johnson J drew an analogy with land. Banning or restricting sales or dealings with the freehold does not affect the derivation of income from its use – eg income from an amusement park. Banning dealings with the satellites does not preclude dealings with the ability to use them and sales of capacity were the business of the group, stymied if this were not permitted.
- (3) The Licence Exception (paras 103–105) was similar in that it permitted the grant of licences by members of the group to enable customers to access services provided by the group. It did not relate to the alienation of licences held by members of the group.
- (4) The Obsolete Exception (para 97) allowed the company to sell worn out, damaged or obsolete equipment, but this would not apply to any intangible assets such as the licences and satellite filings.
- (5) The Useful Exception (paras 98-100) allowed for the sale of equipment which the company no longer found useful for the business of the group.

In the end therefore Johnson J decided (para 123) that the Asset Sales Exceptions did not allow the company to sell the relevant assets in the normal course of business.

THE CHARACTERISATION ISSUE

Being able to dispose of them in “the normal course of business” is at the core of a charge being floating rather than fixed. This derives from the decision in *Re Yorkshire Woolcombers Association* [1903] 2 Ch 284. The question of distinguishing fixed from floating can be fraught, however. Lenders

may seek to have their charge characterised as fixed for priority reasons, fixed charges ranking higher than both floating charges and preferential creditors.

There have therefore been a string of decisions relating primarily to book debts where lenders sought to characterise the charge as fixed and borrowers as floating. Johnson J began his treatment at paras 26-27 of the characterisation issue with a substantial discussion of one of these decisions, that of *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28, [2001] 2 AC 710. The Privy Council provided the current restatement of the law in England – although by the time the decision was handed down the common law had been supplanted in New Zealand by the coming into force of the Personal Property Securities Act 1999. The Board identified two stages to the process. In the first stage the court identifies what rights are granted to the chargee and in the second stage the court determines – as a matter of law – whether the charge is fixed or floating. It is important that this is a matter of law. The parties might agree the charge is “fixed”, but if on analysis the rights of the parties indicate it is “floating” it will be treated as so. The label the parties grant the charge is not therefore determinative at the second stage.

The judge went on to consider the decision of the House of Lords in *NatWest v Spectrum Plus* [2005] UKHL 41. Famously Lord Scott said at para 111 in a dictum quoted by Johnson J (para 29):

“In my opinion, the essential characteristic of a floating charge, the characteristic that distinguishes it from a fixed charge, is that the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime, the chargor is left free to use the charged asset and to remove it from the security.”

While the label that the parties use is not determinative at the second stage, it is important at the first stage as a guide to the rights the parties intended to create. An important distinction is also drawn by Johnson J at para 35 between circulating and non-circulating assets or capital, circulating capital being the natural subject of a floating charge. The critical question at the second stage is one of control. The question of control was discussed in *Re Cimex Tissues* [1995] 1 BCLC 409, where the judge specifically said (at para 31) that a licence to deal “to some extent” with the charged assets is not inconsistent with its being a fixed charge. If – like stock-in-trade or book debts – the property fluctuates over time the charge is likely floating. If, as on the facts of *Cimex*, the assets were specific (a forklift truck and machinery for the production of toilet paper) some licence to deal may be consistent with a fixed charge. The nature of the chargor's business is also important as indicating what the “ordinary course” of its business might be and require. Post-contractual conduct in not enforcing restrictions might also indicate they were never intended and were a sham.

Johnson J quoted from *Goode and Gullifer on Legal Problems of Credit and Security* (7th edn, Sweet and Maxwell, London, 2022) para 4.23 and Beale, Bridge and Gullifer (eds) *The Law of Security and Title-Based Financing* (3rd edn, OUP, Oxford, 2018) para 6.110. Each book maintains the view that a total prohibition on dealings is the only sure way to ensure that the charge is characterised as a fixed charge, as did S Worthington and I Mitchkowska in 'Floating Charges: The State of Play' (2008) 9 JIBFL 467, also referred to by his Lordship (but see 'S Worthington in 'Fixed and floating charges: still favouring absolutism over multi-factored nuance' (2023) 9 JIBFL 583).

Johnson J disagreed with this analysis of the law, arguing at paras 111-112 that the speeches of Lord Scott and Lord Walker in *Spectrum Plus* do not support the authors' proposition. The key is that if the chargor may freely remove the assets from the security without the chargee's consent the charge is floating. What matters is the degree of control of the chargee. Johnson J was correct to observe that this does not require a total prohibition and correct to observe that there will be a continuum between the chargor's having full ability to withdraw assets at will (floating) and no ability at all to do so (fixed). His Lordship also observed (para 119) that it was not “sensible or feasible to try to identify the location of the point on the spectrum of possibilities where a floating charge gives way to a fixed charge, or vice versa”. This is also correct. Courts and practitioners will need to engage in a judgement call about where on the continuum their case falls and whether the chargee's use of the assets is “materially and significantly” limited (para 125).

CHARACTERISATION OF FLOATING CHARGES WITH RESPECT TO DIFFERENT ASSET TYPES

This section aims to provide some guidance as to the implications of the decision and where the line might be drawn with respect to different types of asset.

Stock-in-trade

Stock-in-trade will almost always attract a floating charge rather than a fixed one. The chargor will need to be able to sell these circulating or fluctuating assets to survive and not to be able to do so will stymie his business completely.

Tangible assets

Tangible assets like plant and machinery which are used to manufacture the chargor's stock in trade are likely subject to fixed charges. A chargor is likely to want to dispose of "damaged worn out or obsolete" equipment, precisely what was allowed under the Obsolete Exception; the chargee is not likely to be interested in a charge over an asset that has come to the end of its useful lifespan, but *Avanti* provides useful conformation that this type of permission does not render the charge floating.

Fixed assets like plant and machinery are more like income-generating assets and this is how the secured assets were described in *Avanti* itself. Johnson J describes the Relevant Assets in *Avanti* as being the tangible and intangible infrastructure of the company used to generate its business income. They did not need to be sold to generate income and were inherently difficult to sell; a fixed charge is therefore the more likely analysis. Distinctions between the

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assets, licences to use them and the income or products made will be key.

Shares and rights to dividend payments

In *Arthur D Little v Ableco* [2002] EWHC (Ch) 701, [\[2002\] 1 WLR 1382](#)  it was said that rights to dividend payments were merely ancillary to the shares themselves; in *Ableco* itself the shares could not be sold meaning the charge over the shares was fixed, but this would not preclude the free use of dividend payments by the chargor. One difficulty is where the line is drawn between ancillary and non-ancillary matters.

In *Re New Bullas Ltd* [1994] 1 BCLC 485 the charge over the debts themselves was fixed and the proceeds had to be paid into a specified bank account, but if no instructions were given as to their use the chargor was able to use the proceeds in the normal course of business, rendering it a floating charge over the proceeds.

This split of fixed over the debt and floating over the proceeds was rejected in *Agnew v CIR* where it was said at paras 45-46 that any attempt to separate ownership of the proceeds from ownership of the debts, even if it made conceptual sense, made no commercial sense. The reasoning behind this was essentially that the entire value of the debt was in the income it represented – the right to receive payment. It is not true that the entire value of a share in a company lies in dividend payments; at least one would not normally expect this to be the case. Three related questions must be asked.

- First, how closely linked to the asset is the income?
- Second, how close is the income to being the only value of the asset?
- Third, is the asset destroyed by the income – as it is in the case of book debts, but is not in the case of shares?

Limited ability to use/substitute assets, withdraw excess from a collateral pool

A separate question is whether the assets themselves, be they tangible plant or intangible, can be freely disposed of, which may be more likely in the case of cash collateral, stock or book debts.

Re Avanti Communications Ltd does allow for some limited exceptions allowing for an asset's disposal under a fixed charge, but some have little application to intangibles.

Re Cimex points to another possibility, namely that the substitution of new machinery for old is not inconsistent with the charge's being fixed. There are possible implications for reg 3 of the Financial Collateral Arrangements (No 2) Regulations 2003 which allows (among other consequences) for a charge not to be registered in cases where the collateral taker has possession and control of the collateral.

Prior to *Avanti* there was a set of floating charges where the degree of control over the financial collateral was such that they fell within the regulations. There may be fewer (or no) cases of floating charges being caught by the regulations as the charge can be construed as fixed if, despite some ability of the chargor to use the assets, the chargee has "materially and significantly limited" the former's freedom to do so and has control in this sense.

In *Re Lehman Bros* [2012] EWHC 2997, [2014] 2 BCLC 295 [132-133] Briggs J argued that control meant negative control, subject to a proviso that it was not present if the collateral provider were able to substitute assets for those of equivalent value and withdraw any excess. He argued this effectively meant that the collateral taker's rights are that the collateral provider maintain an adequate collateral pool. A charge of this nature would be floating, but not engage the regulations.

Avanti taken together with *Cimex* might suggest the charge should be seen as fixed, but this raises questions of how control can fix a charge without counting as possession and control for the purposes of the regulations. The issues will need to be carefully worked out; different levels of control and ability to substitute will be appropriate in different contexts.

Cryptoassets

In this context it is typical to require over-collateralisation of up to 150-200% of loan value. The borrower may often withdraw collateral if the value of the deposited assets rises above the minimum required, but a margin call is made, or assets sold if the value falls below the minimum. Just as with the chargor's ability to withdraw only excess financial collateral, such control might constitute a material and significant limitation on the chargor's ability to freely use the assets in the normal course of business, so that it can be characterised as a fixed charge.

CONCLUSION

The proposition that in order to avoid the charge being characterised as floating the assets had to be completely immobilised was always implausible. That this has now been explicitly recognised is a welcome development. As Johnson J said, it is a matter of judgment whether any given restrictions will lead to a charge being fixed and it is impossible to lay down strict rules or criteria in advance, but this article has tried to set out some of the implications for different types of assets.

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Further Reading:

Identifying floating charges after *Re Avanti Communications Ltd* (in Administration)

- Fixed and floating charges: still favouring absolutism over multi-factored nuance (2023) 9 JIBFL 583.
- Floating charges: the current state of play (2008) 9 JIBFL 467.
- Lexis+® UK: Practical guidance video: *Re Avanti Communications Ltd* [2023] EWHC 940 (Ch).

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