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. …

Their Lordships consider that *New Bullas* was wrongly decided.

[12.20] Re Spectrum Plus Ltd [2005] UKHL 41, [2005] 2 AC 680 (House of Lords)

The company granted a charge over its book debts to the bank, expressed to be 'by way of specific charge', prohibiting disposal of the book debts and requiring the proceeds to be paid into an account with the chargee bank. The bank permitted the company to draw on these proceeds for use in the ordinary course of business, subject to certain restrictions. In its terms, the charge was in the same form as that which had been accepted by Slade J as a fixed charge in *Siebe Gorman*.[30] If it was a floating charge, the preferential creditors would be entitled to have their debts paid out of the proceeds of the book debts in priority to the bank (IA 1986 s 175); if not, the bank would be entitled to the whole of the proceeds. The amount at stake was relatively trivial (approximately £16,000). But the case was run as a test case, with several hundred liquidations held up pending the resolution of the issue. The debenture was in a form used by many banks and other commercial lenders. Indeed, the company had gone into liquidation and took no part in the proceedings; the case was argued between the bank (as the secured creditor) and the Crown (as preferential creditor in the liquidation (see 'Distribution of assets subject to the receivership', pp 787ff)).

LORD HOPE:… [I]t is competent for anyone to whom book debts may accrue in the future to create for good consideration an equitable charge upon those book debts which will attach to them as soon as they come into existence. But if this is to be effective as a fixed security everything depends on the way the security agreement ensures that the charge over the book debts is fixed. It is not easy to reconcile the company's need to continue to collect and use these sums for its own business purposes with the lender's wish to escape from the priority which section 175(2)(b) of the 1986 Act gives to preferential debts …

There are, as Professor Sarah Worthington has pointed out, a limited number of ways to ensure that a charge over book debts is fixed: *An 'Unsatisfactory Area of the Law'—Fixed and Floating Charges Yet Again* (2004) 1 International Corporate Rescue 175, 182. One is to prevent all dealings **(p. 629)** with the book debts so that they are preserved for the benefit of the chargee's security. … One can, of course, be confident where this method is used that the book debts will be permanently appropriated to the security which is given to the chargee. But a company that wishes to continue to trade will usually find the commercial consequences of such an arrangement unacceptable. Another is to prevent all dealings with the book debts other than their collection, and to require the proceeds when collected to be paid to the chargee in reduction of the chargor's outstanding debt. But this method too is likely to be unacceptable to a company which wishes to carry on its business as normally as possible by maintaining its cash flow and its working capital. A third is to prevent all dealings with the debts other than their collection, and to require the collected proceeds to be paid into an account with the chargee bank. That account must then be blocked so as to preserve the proceeds for the benefit of the chargee's security. A fourth is to prevent all dealings with the debts other than their collection and to require the collected proceeds to be paid into a separate account with a third party bank. The chargee then takes a fixed charge over that account so as to preserve the sums paid into it for the benefit of its security.

The method that was selected in this case comes closest to the third of these. It was selected, no doubt, because it enabled the company to continue to trade as normally as possible while restricting it, at the same time, to some degree as to what it could do with the book debts. The critical question is whether the restrictions that it imposed went far enough. There is no doubt that their effect was to prevent the company from entering into transactions with any third party in relation to the book debts prior to their collection. The uncollected book debts were to be held exclusively for the benefit of the bank. But everything then

depended on the nature of the account with the bank into which the proceeds were to be paid under the arrangement described in clause 5 of the debenture. As McCarthy J said in *In re Keenan Bros Ltd* [1986] BCLC 242, 247, one must look, not at the declared intention of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention. Was the account one which allowed the company to continue to use the proceeds of the book debts as a source of its cash flow or was it one which, on the contrary, preserved the proceeds intact for the benefit of the bank's security? Was it, putting the point shortly, a blocked account?

I do not see how this question can be answered without examining the contractual relationship in regard to that account between the bank and its customer. An account from which the customer is entitled to withdraw funds whenever it wishes within the agreed limits of any overdraft is not a blocked account. In *Agnew v Comr of Inland Revenue* [2001] 1 AC 710, 722, para 22 Lord Millett said that the critical feature which led the Irish Supreme Court in *In re Keenan Bros Ltd* [1986] BCLC 242 to characterise the charge on book debts as a fixed charge was that their proceeds were to be segregated in a blocked account where they would be frozen and unusable by the company without the bank's written consent. I respectfully agree. … [He then considered the arrangements in *Siebe Gorman* and in this case, and decided that neither were effective to block the account in the way required. He then continued:]

Should Siebe Gorman be overruled?

Lord Phillips of Worth Matravers MR [in this case in the Court of Appeal] said that, even if Slade J's construction of the debenture in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 had appeared to him to be erroneous, he would have been inclined to hold that the form of the debenture had, by custom and usage, acquired the meaning and effect that he had attributed to it: [2004] Ch 337, 383, para 97. This was because the form had been used for 25 years under the understanding that this was its meaning and effect. Banks had relied upon this understanding, and individuals had guaranteed the liabilities of companies to banks on the understanding that the banks would be entitled to look first to their charges on book debts unaffected by the claims of preferred creditors. The respondents say that this is the course that ought now to be followed in the interests of commercial certainty.

… It is hard to think of an area of the law where the need for certainty is more important than that with which your Lordships are concerned in this case. The commercial life of this country depends to a large extent on the reliability of the security arrangements that are entered into between debtors **(p. 630)** and their creditors. The law provides the context in which these arrangements are entered into, and it lays down the rules that have to be applied when the arrangements break down. Mistakes as to the law can make all the difference between success and failure when the creditor seeks to realise his security. So a heavy responsibility lies on judges to provide the lending market with guidance that is accurate and reliable. This is so that mistakes can be avoided and transactions entered into with confidence that they will achieve what is expected of them.

These are powerful considerations, but I am in no doubt that the proper course is for the *Siebe Gorman* decision to be overruled. … This is not one of those cases where there are respectable arguments either way. With regret, the conclusion has to be that it is not possible to defend the decision on any rational basis. It is not enough to say that it has stood for more than 25 years. The fact is that, like any other first instance decision, it was always open to correction if the country's highest appellate court was persuaded that there was something wrong with it. Those who relied upon it must be taken to have been aware of this. …

[He therefore held *Siebe Gorman* was wrong and should be overruled, and allowed the appeal.]

LORD WALKER: [Describing the essential difference between a fixed charge and a floating charge:] Under a fixed charge the assets charged as security are permanently appropriated to the payment of the sum charged, in such a way as to give the chargee a proprietary interest in the assets. So long as the charge remains unredeemed, the assets can be released from the charge only with the active concurrence of the chargee. The chargee may have good commercial reasons for agreeing to a partial release. If for instance a bank has a fixed charge over a large area of land which is being developed in phases as a housing estate

(another example of a fixed charge on what might be regarded as trading stock) it might be short-sighted of the bank not to agree to take only a fraction of the proceeds of sale of houses in the first phase, so enabling the remainder of the development to be funded. But under a fixed charge that will be a matter for the chargee to decide for itself.

Under a floating charge, by contrast, the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a fund of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the trader, and not the bank, to decide how to run its business. …

[He therefore held *Siebe Gorman* was wrong and should be overruled, and allowed the appeal.]

BARONESS HALE and LORDS SCOTT, NICHOLLS, STEYN and BROWN all delivered concurring opinions.

➤ Notes

1. *Spectrum* **[12.20]** and *Brumark* **[12.19]** are worth reading in full for a proper appreciation of the area. The *Spectrum* case also addresses the issue of 'prospective overruling' by the House of Lords (pursuant to the argument put by the bank that even if *Siebe Gorman* were overruled, the overruling should only have an impact on charges created after the date of the decision). The Law Lords unanimously agreed the power existed, but refused to exercise it in the circumstances.

2. *Re SSSL Realisations Ltd* [2004] EWHC 1760 (Ch), confirmed, if that were necessary, that it is possible to create a charge only on the proceeds of collection of debts without charging the debts themselves at all.

3. In *Arthur D Little Ltd v Ableco Finance LLC* [2002] EWHC 701 (Ch), it was reaffirmed that a chargor may enjoy the 'fruits' of the property that has been subjected to a*fixed* charge, without thereby converting the charge to a floating charge. Mr Roger Kaye QC said:

> As Nicholls LJ put it in *Re Atlantic Computer Systems Plc* [1992] Ch 505 at 534G: 'A mortgage of land does not become a floating charge by reason of a mortgagor being permitted to remain in possession and enjoy the fruits of the property charged from time to time.' The receipt of dividends and other rights arising by virtue of the shares seem to me to be examples of exploitation of the principal **(p. 631)** subject matter of the charge, i.e. the shares. As Lord Millett again expressed in the*Brumark* case[31] at page 727, paragraph 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.'

4. The reach of *Spectrum* has been tested in numerous cases now. In *Re Rayford Homes Ltd (In Admin. Rec.)* [2011] EWHC 1948 (Ch), [2011] BCC 715, trustees involved in a priority dispute unsuccessfully argued that the bank's fixed charge over the company's future-acquired investment property was on a proper analysis a floating charge because when the property was sold, the company was free to draw on the proceeds and could keep any excess after repayment of the advances referable to the property in question. David Richards J held that these features did not affect the status of the charge as a fixed charge:

> 44 In my judgment, the essential difference between that case and the present lies in the difference in the ability of the chargor company to deal with the charged property. Spectrum Plus Ltd was entitled to collect book debts without any involvement or prior consent of the bank. In the present case, the company could not realise any freehold or leasehold property without a release by the bank of its legal charge and the fixed

charge in the debenture. Indeed, assuming that the charges were registered at the Land Registry against the title to each property as they were required to be (see cl.5 of the legal charges and cl.3.4 of the debenture), the company could not make good title on an unencumbered transfer without the bank's release of its security.

45 By the terms of both the debenture and the legal charges, the charges stood as security for all monies due to the bank. The provisions of the facility letter are not in conflict with the debenture and legal charges. Paragraph 2.3.1 of the facility letter is a provision for repayment: the advances referable to a particular property must be repaid on a sale of that property. It does not affect the extent of the bank's security on the property. It does not modify the terms of the legal charges, so that they are fixed charges securing only repayment of the sums to which para. 2.3.1 refers.

46 It is always open to the holder of a fixed charge over property to release the charge on payment of less than is secured by the charge, as specifically mentioned by Lord Walker of Gestingthorpe in *Spectrum* **[12.20]** at [138]. The fact that the company is then free to use the surplus proceeds as it wishes does not affect the status of the charge on the property as a fixed charge. For these reasons I conclude that the fixed charge on future-acquired property in the debenture and the legal charges were and are effective as fixed charges securing all monies due from the company to the bank.

5. Just as *Cosslett* **[12.08]** was something of a wake-up call in reminding parties that charges may arise when not intended (and worse, turn out to be void), so too in *Gray v G-T-P Group Ltd* [2010] EWHC 1772 (Ch). In an action by the liquidators (G), Vos J applied the *Spectrum* **[12.20]** reasoning to hold that a *declaration of trust* entered into between the company in liquidation (F) and the respondent (G) was void as an unregistered floating charge on F's property. F sold laminated floors; G supplied store debit card services. Sums paid by F's customers using the debit cards were paid into a designated bank account. G held these balances on trust for F, and it was agreed that 'except in the circumstances referred to in clause 3' F was to have effective control over the account. Clause 3 gave G access to the account to recoup sums owed to it in defined circumstances, including F's breach or F's insolvency. The judge concluded that Clause 3 created a charge, and that the charge was necessarily floating since F could draw on the account at will, and the assets subject to the charge defined in Clause 3 were not to be finally appropriated as a security for the payment of the debt until the occurrence of some future event.

(p. 632) ➢ Question

Does it follow from these decisions that the commercial objectives which *New Bullas* sought to meet are now impossible to achieve? Draftsmen will clearly need to make sure that collections made by the company are held for the chargee's account (eg by being paid into a blocked bank account) and only after that released by an act of the chargee into the chargor's general funds. Can this be done in a way that is commercially attractive?

Avoiding the statutory regime for company securities

There are various practical mechanisms that can be adopted by way of 'quasi-security' in order to gain some of the benefits of being a secured creditor without the effort and expense (and possible disadvantages) of the fixed and floating charge regime just described. To this end, creditors use conditional sales, hire-purchase arrangements, trusts (eg building retention trusts, *Quistclose* trusts[32]), and other such devices.

Retention of title agreements are considered here, simply by way of illustration.

Retention of title agreements

Most trading companies use bank overdrafts to meet their short-term financial needs, and commonly also rely on bank loans for longer term credit. Almost invariably, such advances will be secured by floating charges over all the

company's assets, and possibly by an array of fixed charges as well. In the event of insolvency, the bank and those creditors who are entitled to a statutory preference (see 'Distribution of assets subject to the receivership', pp 787ff) are likely between them to claim all that the company has, leaving ordinary trade creditors with nothing.

Many commentators have considered this situation to be unfair—see, for example, the Cork Committee's report (Cmnd 8558, 1982, para 1950) and the remarks of Templeman J in *Business Computers v Anglo-African Leasing Ltd* [1977] 1 WLR 578 at 580. Admittedly, some of these criticisms centred on the statutory provisions that accorded to the Crown status as a preferred creditor for many of the debts (including taxes) owed to the Crown. This preference was abolished by the Enterprise Act 2002 (see 'Liquidation or winding up', p 788).

Nevertheless, even as regards the normal operation of floating charges, there is particular unfairness in relation to those who supply the company with goods on credit—perhaps the raw materials needed for its manufacturing processes. The goods delivered become subject immediately to the floating charge (if, as is usual, it affects future property), even though it is the seller and not the bank who is providing this particular asset by way of credit. So suppliers have endeavoured to protect themselves by 'retention of title' clauses. There is nothing novel about this: the familiar hire-purchase agreement serves the same purpose. A Dutch supplier succeeded in defeating the claims of a receiver in this way in the celebrated *Romalpa* case **[12.21]** in 1976.

[12.21] Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd [1976] 1 WLR 676 (Chancery Division and Court of Appeal)

Aluminium foil was supplied by the plaintiffs, a Dutch company, to the defendants for processing in their factory. It was stipulated in the contract of sale that ownership of the foil should not **(p. 633)** be transferred to the buyers (the defendant purchasing company) until the price had been paid in full; that products made from the foil should be kept by the buyers as bailees (the contract, which was a translation from a Dutch draft, used the un-English expression 'fiduciary owners') separately from other stock, on the supplier's behalf, as 'surety' for the outstanding price; but that the buyers should have power to sell the manufactured articles in the ordinary course of business, such sales to be made by them as the suppliers' agents. Mocatta J, whose judgment was affirmed by the Court of Appeal, held that the retention of title clause was effective to retain legal title to the aluminium in the hands of the supplier; in addition, the suppliers could trace the price due to them into the proceeds of sales of the finished goods made by the buyers, ahead of the latter's secured and unsecured creditors.[33]

> MOCATTA J: The preservation of ownership clause contains unusual and fairly elaborate provisions departing substantially from the debtor/creditor relationship and shows, in my view, the intention to create a fiduciary relationship to which the [tracing] principle stated in *Re Hallett's Estate*[34] applies. A further point made by Mr Pickering was that if the plaintiffs were to succeed in their tracing claim this would, in effect, be a method available against a liquidator to a creditor of avoiding the provisions establishing the need to register charges on book debts: see s 95(1), (2)(e) of the Companies Act 1948 [now see CA 2006 s 859A]. He used this only as an argument against the effect of clause 13 contended for by Mr Lincoln. As to this, I think Mr Lincoln's answer was well founded, namely, that if property in the foil never passed to the defendants with the result that the proceeds of sub-sales belonged in equity to the plaintiffs, s 95(1) had no application.
>
> The plaintiffs accordingly succeeded and are entitled to the reliefs sought.
>
> [The decision of Mocatta J was affirmed by the Court of Appeal.]

➢ Notes

1. Since this decision, draftsmen of suppliers' contracts have endeavoured to adopt and improve upon 'Romalpa clauses' with varying success. In those cases where the goods sold are still in the hands of the company and identifiable, the supplier has usually been successful. But in other cases the danger is that the

court will hold that a charge has been created, which may be void in a subsequent insolvency for non-registration under CA 2006 ss 859Aff and will, in any event, probably rank after the bank.

2. The reach of retention of title clauses is a matter of contractual interpretation. In *Sandhu (t/a Isher Fashions UK) v Jet Star Retailer Ltd (In Administration)* [2011] EWCA Civ 459, CA, the Court of Appeal rejected the seller's claim for conversion/wrongful interference of goods subject to a retention of title clause. An express clause enabled the seller to withdraw the buyer's authority to deal with the goods in the ordinary course of business. However, until such withdrawal was made, on a proper construction, the court was satisfied that it had been the parties' contemplation that the buyer be permitted to continue to deal with the goods (in whatever ways it desired) even after it had become insolvent. By contrast, in *Wincanton Group Ltd v Garbe Logisitics UK 1 SARL, Jenks Sales Brokers Ltd (In Administration)* [2011] EWHC 905 (Ch), it was agreed that title to certain industrial storage racks would not pass to Wincanton until *all* outstanding debts in relation to certain works had been met. The condition was not satisfied, so W could not claim title.

3. *Re Bond Worth Ltd* **[12.07]** established that an attempt to reserve a mere equitable title (at least in a case where the buyer was free to resell) created a charge in the nature of a **(p. 634)** floating charge, which was void unless registered; and later cases have held that the same result follows where the manufacturing process is such as to destroy the identity of the raw material which was originally supplied: *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25 (resin used in making chipboard); *Re Peachdart Ltd* [1984] Ch 131 (leather used for handbags).

4. In regard to claims against the proceeds of sale, suppliers have not been successful unless the clause has created a duty to keep the moneys separate from other funds: *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* [1984] 1 WLR 485. Even then, the natural inference is that a charge has been created, since almost invariably the amount of the price owing to the supplier will be part only of the proceeds of resale: *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 WLR 150, [1987] BCLC 522; *Compaq Computers Ltd v Abercorn Group Ltd* [1993] BCLC 602.

5. There have been pleas for reform of the law so as to make all contracts containing retention of title clauses (and presumably also hire-purchase and leasing contracts) registrable as charges. The Diamond Report (1989), paras 17.8ff and 23.6.10, proposed that a distinction should be drawn between 'simple' clauses, which do no more than retain title to the actual goods sold, or their proceeds if resold, but only in regard to a claim for the original price, and more complex clauses, such as those which purport to assert title to a manufactured product. Professor Diamond recommended that the law should be clarified by a statutory provision which declares the latter category to be registrable as charges and the former to be exempt. These recommendations have not been taken up by the legislature, and the question has been left in limbo during the past two decades and more while various groups have been debating possible reforms to the charges registration system (see 'Further reform of the registration system', pp 604ff).

6. IA 1986 s 15 empowers an administrator, with the leave of the court, to sell property affected by such contracts free from the supplier's interest on terms that the net proceeds are paid in discharge of the debt due to the supplier. (See, eg, *Sandhu (t/a Isher Fashions UK) v Jet Star Retailer Ltd (In Administration)* [2011] EWCA Civ 459, CA.)

Further Reading

ATHERTON, S and MOKAL, RJ, 'Charges over Chattels: Issues in the Fixed/Floating Jurisprudence' (2005) 26 *Company Lawyer* 163.
Find This Resource

BERG, A, 'The Cuckoo in the Nest of Corporate Insolvency: Some Aspects of the *Spectrum* Case' [2006] JBL 22.
Find This Resource

GOODE, R, 'The Case for the Abolition of the Floating Charge' in J Getzler and J Payne (eds), *Company Charges: Spectrum and Beyond* (2006), ch 2.
Find This Resource

LOI, K, 'Quistclose Trusts and Romalpa Clauses: Substance and Nemo Dat in Corporate Insolvency' [2012] LQR 412.
Find This Resource

PENNINGTON, R, 'Recent Developments in the Law and Practice Relating to the Creation of Security for Companies' Indebtedness' (2009) 30 *Company Lawyer* 163.
Find This Resource

WORTHINGTON, S, 'An "Unsatisfactory Area of the Law"—Fixed and Floating Charges Yet Again' (2004) 1 *International Corporate Rescue* 175.
Find This Resource

Notes:

[1] See M Bridge, H Beale, L Gullifer and E Lomnicka, *The Law of Security and Title-Based Financing* (2nd edn, 2012) and M Bridge, L Gullifer, G McMeel and S Worthington, *The Law of Personal Property* (2013).

[2] A lender may, however, be protected from the effect of such restrictions by the internal management rules ('The "indoor management rule"', pp 124ff), by Companies Act 2006 (CA 2006) ss 39–40, or by a provision in the articles.

[3] To do so would infringe the Bills of Sale Acts of 1878 and 1882 (which do not apply to companies), and in any event it would be impossible to describe specifically the goods affected where these are to include assets acquired in the future. The Cork Committee recommended that it should be made possible for an individual to create a floating charge for business purposes: see (Cmnd 8558, 1982), para 1569. Also see P Giddins, 'Floating Mortgages by Individuals: Are They Conceptually Possible?' (2011) 3 *Butterworths Journal of International Banking and Financial Law* 125.

[4] The term 'book debts' is well established in English law, although its exact scope is unclear. Broadly speaking, in the present context it is used to describe the sums due to a company for goods sold or services rendered which have been, or are due to be, invoiced but have not yet been paid. There is growing support for the American expression 'receivables', which is more or less equivalent.

[5] A '*receiver*' takes control of all the assets that are subject to the charge. If the charge covers the entirety of the assets and undertaking of the company, or almost so, then the receiver is typically also given power to administer the company's business, and is then called an '*administrative receiver*'. A charge with this breadth is generally necessarily a combination of fixed and floating charges. The ability of such a chargee to appoint an administrative receiver is now curtailed by the Insolvency Act 1986 (IA 1986): see 'Administrative receivership', pp 779ff.

[6] The charges described in this chapter are all created by agreement between the parties. Charges may also sometimes be created by operation of law (and then are referred to as *equitable liens*, although note that, despite the name, the rights associated with them mirror the non-statutory rights associated with equitable charges, and not the rights associated with contractual liens, which are quite different), but these equitable liens are not relevant for present purposes.

[7] A voluminous literature exists on floating charges, covering both practical and theoretical aspects. See especially J Getzler and J Payne (eds), *Company Charges: Spectrum and Beyond* (2006), and that provides reference to much of the earlier literature.

[8] *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318, CA, provided early confirmation that this is possible.

[9] See Explanatory Notes available at: www.bis.gov.uk/assets/biscore/business-law/docs/e/12-1028-explanatory-

notes-draft-regulations-part-25-companies.pdf.

[10] Under CA 2006 ss 894(1) and 1292(1).

[11] But see *Smith v Bridgend County Borough Council* [2001] UKHL 58, [2002] AC 336 (the appeal of *Cosslett* **[12.08]**), Lord Hoffmann:

> When a winding-up order is made and a liquidator appointed, there is no divesting of the company's assets. The liquidator acquires no interest, whether beneficially or as trustee. The assets continue to belong to the company but the liquidator is able to exercise the company's right to collect them for the purposes of the liquidation … It must in my opinion follow that when [Companies Act 1985 (CA 1985)] s 395 [now CA 2006 s 874] says that the charge shall be 'void against the liquidator', it means void against a company acting by its liquidator, that is to say, a company in liquidation.
>
> The same analysis applies to administration.

[12] Although interestingly the final version of the Regulations omits any specific reference to constructive notice. An earlier draft included s 859R, which explicitly provided for deemed constructive notice in relation to 'any matter requiring registration and disclosed on the register', although the provision remained within square brackets with the accompanying explanatory notes issued by BIS inviting further comments on the issue: see www.bis.gov.uk/assets/biscore/business-law/docs/e/12-1028-explanatory-notes-draft-regulations-part-25-companies.pdf.

[13] See *Wilson v Kelland* [1910] 2 Ch 306. Also see J de Lacy, 'Constructive Notice and Company Charge Registration' [2001] *Conveyancer* 122.

[14] Paragraph 28, 'Government response: consultation on registration of charges created by companies and limited liability partnerships' (December 2010); available at:www.bis.gov.uk/assets/biscore/business-law/docs/g/10-1319-government-response-consultation-registration-of-charges.pdf.

[15] Eg *Re Armagh Shoes Ltd* [1984] BCLC 405 per Hutton J, holding that the charge was floating even though stated to be fixed. Although there was no provision for crystallisation, this did not matter: the charge would crystallise on the winding up of the company or the appointment of a receiver (at 408–411, 419). Also see *Re Brightlife Ltd* [1987] Ch 200, 209 per Hoffmann J (see **[12.12]**). There is a vast body of precedent, going back to the earliest Bills of Sale Acts last century, concerned with the question of whether a composite transaction such as a sale and lease-back is what it purports to be or is in reality a concealed form of charge. For contrasting modern illustrations, see *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148, CA (agency with power to sell held genuine) and *Re Curtain Dream plc* [1990] BCLC 925 (purported sale and repurchase held to be a disguised form of security).

[16] Unsurprisingly, then, these charges are not registered as required by CA 2006 s 874 (or its predecessor, CA 1985 s 395) and so are ineffective to give priority on the chargor's insolvency: see 'Requirement to register charges', p 601.

[17] The debentures contained a provision that the company was not at liberty to create any mortgage or charge having priority to the floating charge, but the bank had no knowledge or notice of this 'negative pledge' provision, and so was held not to have been affected by it. Contrast the current rules: see 'Registration, priority and constructive notice of registered charges', p 603.

[18] Although if there is a negative pledge clause, B will now have constructive notice of it, and A's charge will prevail: see 'Registration, priority and constructive notice of registered charges', p 603.

[19] A majority of the court in *Fire Nymph Products Ltd v Heating Centre Pty Ltd* (1992) 7 ACSR 365 (NSWCA) held that a floating charge also crystallises when the charged assets are dealt with otherwise than in the ordinary course of business. This might well be the case where the assets concerned comprised all or a substantial part of

the company's property, or the whole of the assets affected by the charge, but it is doubtful that the *dictum* would apply to the disposal of individual items.

[20] The Cork Committee (Cmnd 8558, 1982, paras 1578–1579) considered that automatic crystallisation was 'not merely inconvenient', but that there was 'no place for it in a modern insolvency law'. The Committee recommended that the circumstances in which a floating charge crystallised should be defined by statute, and that all other ways (including automatic crystallisation) should be banned.

[21] [1978] 5 WWR 652.

[22] Exceptionally, such a debt may be set off if it arises out of the same contract as that which gives rise to the assigned debt, or is closely connected with that contract:*Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 2 All ER 741 at 748, per Templeman J.

[23] The statute did not then provide remedies against non-fraudulent preferences. Now see IA 1986 ss 238–241, and *Re MC Bacon Ltd* **[16.15]**.

[24] Prior to IA 1986, the legislation used the phrase 'cash paid to the company': but it would appear that the decision in *Re Yeovil Glove Co Ltd* is not affected by the change in wording.

[25] (1816) 1 Mer 572, under which the earliest payments into an account are set off against the earliest payments out, and vice versa.

[26] (1925), reported [1965] Ch 186n.

[27] This was the case in *Re Brightlife Ltd* **[12.12]**, where the debenture holder had given the company a notice converting the floating charge into a fixed charge a week before a resolution for voluntary winding up was passed. The court held that the preferential creditors no longer had any right to be paid in priority to the charge.

[28] (1870) 5 Ch App 318, CA.

[29] [1979] 2 Lloyd's Rep 142.

[30] [1979] 2 Lloyd's Rep 142.

[31] [2001] 2 AC 710.

[32] Named after the seminal case, *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567, HL.

[33] This second aspect of the decision is now regarded as justifiable, if at all, on the special terms of the contract. But the analysis in relation to basic retention of title clauses stands firm, and is much used in commercial practice.

[34] (1880) 13 Ch D 696.

13. Remedies for Maladministration of the Company

Chapter: **(p. 635)** 13. Remedies for Maladministration of the Company
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General issues

The earlier chapters illustrate that either the directors or the members in general meeting (but generally the directors) have responsibility for the affairs of the company. This chapter looks both at who can seek remedies if the company is poorly run and at which matters are the legitimate subject of complaint. In particular, it examines whether complaints can be made only about 'legal wrongs'—negligence, breach of statutory duty, etc—or also about more general issues of perceived 'maladministration', including management approaches that are simply not in accordance with expectations. It also considers some of the problems that arise because the company is an 'association' of members, run by a 'board' of directors, so issues of majority rule have to be addressed (see 'Why is shareholder litigation such a problem?', pp 635ff). Finally, it looks at the problems of potential double recovery where both the company and its individual members seem to be entitled to remedies for particular wrongs (see 'Personal claims by members', pp 667ff).

Pursuing claims for maladministration

In pursuing claims for maladministration, the usual problem, of course, is that the people causing harm to the company (whether the directors or the majority shareholders) are usually also the people in control of the company. They are unlikely to pursue litigation against themselves. The relevant company law rules must address this difficult issue, while at the same time avoiding the problem of allowing every vexatious or litigious member to complain about activity that is to all intents and purposes acceptable to the company's various participants and interest groups.

The types of action examined in this chapter fall into slightly overlapping categories (the overlaps caused in large measure by statutory interventions).

Actionable wrongs committed against the company

If an actionable wrong has been done to the company, then the company has a cause of action which it may pursue in legal proceedings, just like any other legal person. Again, like any other legal person, it is not *obliged* to pursue every possible claim it has. Where the company's claim is against its own directors, however, it is clearly unsafe to leave the decision about whether the company should sue in the hands of those same directors. Accordingly, one special rule that allows members to pursue these company claims in very tightly defined circumstances has been added to the general rules in an attempt to address this problem. In sum, and including the special rule, the company may pursue its own legal claims (in its own name in all but point (iv)) by means of a decision to do so taken by:

(i) The company's directors, acting within their normal powers of management of the company (if, as is usual, this is what the articles provide by way of power sharing(p. 636) within the company). Pragmatically, if the action is against one or more of the company's own directors, then such a decision to sue is only likely if the majority of directors is not aligned with the wrongdoers (even though the wrongdoers remain in post), or if a new board has taken over the management of the company and the old directors have been ousted. See, for example *John Shaw and Sons (Salford) Ltd v Shaw* **[4.07]** and *Regal (Hastings) Ltd v Gulliver* **[7.23]**.
(ii) The company's administrator or liquidator (in an administration or a winding up), since neither is likely to be diverted by personal allegiances to past directors.
(iii) The general meeting, in those rare cases where it seems that the general meeting has either primary or residual control over the company's power to litigate (but see *Breckland Group Holdings Ltd v London &*

Suffolk Properties Ltd [1989] BCLC 100 (Ch)).
(iv) Individual members, using the statutory procedure that allows them to take a '*derivative action*': Companies Act 2006 (CA 2006) ss 260ff. A derivative action is taken in the name of the member, but in pursuit of a claim that belongs to the company, and for a remedy that will accrue to the company and not to the member as an individual. The company is brought before the court compulsorily (and so as a *defendant*, rather than a claimant), so as to ensure that it is subject to the jurisdiction and orders of the court in circumstances where those with actual power to cause the company to pursue its own claims are resisting this option.[1]
(v) The Secretary of State, under powers set out in the Companies Act 1985 (CA 1985) s 438 (see 'Public investigation of companies', pp 730ff; note, these few CA 1985 provisions remain operative).

Actionable wrongs committed against individual members

If a wrong has been done to the member personally (rather than to the company), then the member may pursue his or her claim against the company, or against the other (ie majority) members in the company, by way of:

(i) A *personal action* (or a *representative action*[2]) based on the contract the member has with the company as set out in the company's constitution (CA 2006 s 33) (see 'Members' personal rights', pp 250ff).
(ii) A *personal action* (or a *representative action*) based on other contracts the member may have with the company or with the body of members (see 'Shareholders' agreements', pp 244ff).
(iii) A *statutory action* permitted by certain specific provisions in CA 2006 (see, eg, the provisions applying to reductions of capital or variation of class rights at 'Permitted reductions of capital', pp 513ff and 'Variation of class rights', pp 563ff).
(iv) A statutory action to remedy '*unfair prejudice*' (CA 2006 s 994) (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff).
(v) A statutory action to *wind the company up on the just and equitable ground* (IA 1986 s 122(1)(g)) (see 'Compulsory winding up on the "just and equitable" ground', pp 795ff).

It is not necessary to examine all of these options in detail in this chapter. However, it is necessary to be alert to the range of different procedures that are available for remedying **(p. 637)** different forms of maladministration. Where the normal process for pursuing well-recognised legal claims is adopted (as where the *company* sues its directors for *negligence*), then nothing more needs to be added to the earlier discussion of how a company acts (see 'General issues', pp 309ff) and what constitutes directors' negligence (see 'Duty to exercise reasonable care, skill and diligence: CA 2006 s 174', pp 353ff). Similarly, where the company or an individual pursues claims that are based on special statutory rights, it is not necessary to re-examine those special rights described earlier (eg individual member's rights of action based on the statutory contract with the company, or the statutory right to complain about reductions of capital or variation of class rights, see 'Members' personal rights', pp 250ff, 'Permitted reductions of capital', pp 513ff and 'Variation of class rights', pp 563ff). This chapter therefore focuses only on the availability of special rights of access to the court (see company claims in points (iii) and (iv) in the previous list), and special grounds of complaint (see members' claims at point (iv), while point (v) is considered in Chapter 16, along with the other grounds for the winding up of companies) in relation to maladministration.

Some of the issues addressed in this chapter were previously dealt with under quite different common law rules (especially the rule in *Foss v Harbottle* **[13.01]**), now replaced by provisions in CA 2006. Care must therefore be taken in referring to older authorities.

Why is shareholder litigation such a problem?

The practical problem which the law has to deal with in this area is balancing the risk that too little litigation is pursued because the wrongdoers are in control, or that too much litigation is pursued because vexatious individuals are disaffected with the majority-determined status quo. The law must therefore define proper limits to litigation control and majority rule. At the same time, it must be conceded that the general rule *is* majority rule, whether by directors or by members (sometimes, in the latter case, with the added protection of super-majorities, or segregated classes of interest groups), so there is always the likelihood of disaffected dissenting minorities. 'Majority rule' applies not only to decisions to pursue business activities, but also to decisions *not* to pursue