



Siebe Gorman "is wrong"

JANUARY 2004

A summary of the judgment in *National Westminster Bank Plc v Spectrum Plus Limited (in creditors' voluntary liquidation) & others (Re Spectrum Plus Limited)* handed down by Morritt VC on 15 January 2004.

". . . *Siebe Gorman* has stood for 25 years with little criticism. It is suggested that most bank's standard forms are drafted on the assumption that *Siebe Gorman* was correctly decided and that thousands of liquidations have been conducted on the same assumption [(paragraph 27)] . . . It is with the greatest hesitation and reluctance that I differ from the conclusion of Slade J in *Siebe Gorman*. Nevertheless I am convinced that it is wrong" (paragraph 39).

Morritt VC

1 Introduction

- 1.1 Since *Brumark* (advice delivered by Lord Millet in the Privy Council in 2001) there has been a standoff between charge holders who purport to have valid fixed charge security over book debts, and insolvency office holders who have various duties depending on whether or not the charge is fixed or floating. The reason for the standoff is that, on the insolvency of the borrower, proceeds of assets caught by a floating charge must go to pay the preferential creditors before the holder of the floating charge receives anything. This means that, on the insolvency of the borrower, the realisations available to the lender from a floating charge over book debts may be significantly less than realisations available from a fixed charge (subject to the effect of the provisions of the Enterprise Act 2002 concerning the abolition of the preferential status of Crown debts).
- 1.2 The crux of the standoff has centred on the question of what constitutes sufficient control by a charge holder over book debts and their proceeds to enable a charge to be categorised as fixed.

2 Characteristics of a fixed charge on book debts

2.1 In determining the nature of a fixed charge, the Privy Council referred to the decision in *Siebe Gorman & Co Limited v Barclays Bank Limited* [1979] 2 Lloyd's Rep 142 in which it was held that the bank's fixed charge on the uncollected book debts was indeed a fixed charge because it embodied a critical feature of the fixed charge, that is, the company was not free to draw on the account which it had with the bank without the prior consent of the bank, even when the account was in credit. The Privy Council adopted Slade J's definition of the characteristics of a fixed charge on book debts as further developed by the Court of Appeal in Eire in the case of *Re Keenan Bros Ltd* [1986] BCLC 242. Lord Millet summarised the issue arising out of the Irish Court's judgment as follows:

"The critical feature which led the Court 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 rendered unusable by the company without the bank's written consent."

2.2 However, the Privy Council implied that Slade J, who delivered the judgment in *Siebe Gorman*, had been wrong in finding that the terms of the debenture had placed express restrictions on the company's right to draw on the account.

3 Spectrum

3.1 In the summer of 2003 NatWest applied to the Companies Court in the High Court of Justice for a declaration that its debenture over the assets of Spectrum Plus Limited (in liquidation) created a fixed charge over the company's book debts and the proceeds thereof and that an order be given that the liquidators of the company account to the bank in respect of such proceeds.

3.2 The charge in favour of NatWest in the *Spectrum* case was substantively indistinguishable from the debenture in *Siebe Gorman*.

3.3 The question that Morritt VC considered in *Spectrum* was "whether the charge when created contemplated that the company should continue to trade and should until the occurrence of some specified future event be free to use in such trade the class of asset described as book debts".

4 Adverse criticism of the decision in *Siebe Gorman*

4.1 In his judgment, Morritt VC referred to two articles, the first by Professor Roy Goode in an article entitled "Charges over Book Debts: a missed opportunity" (1994) 110 LQR 592 and the second, a reply to Professor Goode's article, by Mr Alan Berg entitled "Charges over Book Debts: a Reply" published in 1995 in *Journal of Business Law*. Morritt VC considered that the criticisms made by Mr Berg of the decision of Slade J in *Siebe Gorman* were well made. In his article, Mr Berg suggested that Slade J gave no real explanation of his conclusion that the company and the bank intended that the debenture would deprive the company of the free disposal of the book debts even before the bank had taken any steps to enforce its security and he concluded (p.469) that:

"*Siebe Gorman* is unsound in deciding that such a general charge is a fixed charge if it requires the company to pay the proceeds into its account with the chargee without expressly prohibiting the company from withdrawing the amounts so paid in."

4.2 Morritt VC also referred to the New Zealand case of *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd* [1994] 3 NZLR 300 and said that Tompkins J, who delivered the judgment, had been correct in concluding that:

". . . a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the Bank. It does not, without more, fasten the charge onto those proceeds. Supercool was free to deal with those proceeds except in the two respects stated, unless and until the BNZ intervened in a manner that would effectively inhibit that freedom.

"This conclusion is entirely consistent with the circumstances, as they existed at the time the debenture was entered into. Supercool was about to take over part of the business of the old Supercool company. It was the clear intention of Supercool and the BNZ that Supercool was then going to trade in the normal way in the course of which it would acquire book and other debts and would be using the proceeds of those debts in the normal course of its business. If it were not able to do so freely, it would not be able to trade. And the BNZ was well aware that that was what Supercool was about to do - the whole object of the finance facility was to enable Supercool to commence business. There was no intervention by the Bank that in any way restricted this freedom to carry on its business until the Bank appointed the receiver on 10 March 1992.

"It follows that the charge over the book and other debts was a floating charge until it crystallised on that date. It also follows that, for the reasons I have expressed, I do not follow the decision of Slade J in *Siebe Gorman*."

5 Three stage test

5.1 With reference to Lord Millet's advice in *Brumark*, Morritt VC referred to the following three stages that needed to be considered in determining whether or not the charge in *Spectrum* constituted a fixed charge over book debts:

5.2 **First stage:** Ascertain by the construction of the Debenture the nature of the rights and obligations that the parties intended to grant each other in respect of the book debts.

5.3 In considering this stage, Morritt VC stated as follows:

". . . in this case the account is an ordinary current account with a clearing bank and there is no express restriction on the operation of the bank account within the limits of the Facility contained in either the Debenture or Facility. The Facility is liable to be withdrawn or reduced on notice and is repayable on demand but unless and until either of those events occur the Company is free to draw cheques in favour of suppliers or creditors in the ordinary conduct of its business as it thinks fit. Indeed it is not possible for any contrary term to be implied given that the purpose of the Facility was to provide working capital and the account was opened as an ordinary current business account with a clearing bank.

". . . The Facility and the other terms on which the account was opened limit the manner in which the account can be operated. The question is not whether those terms affect the construction of the Debenture but whether the Debenture further restricts the manner in which the account may be operated. It is plain that it does not."

5.4 **Second stage:** Ascertain from those rights and obligations whether it was the intention of the parties that the Company should be free to deal with the book debts and withdraw them from the security without the consent of the Bank, i.e. whether it was intended that the book debts should be under the control of the Company or the Bank.

5.5 Concerning this stage Morritt VC stated as follows:

"In my view it is clear that the book debts were to be under the control of and available for use by the Company in the ordinary course of its business through their collection and the ordinary operation of the bank account. . . . There is no restriction on its use for all or any

purposes of the Company's business so long as the overdraft limit is observed, no notice to withdraw or reduce it has been given and no demand for repayment had been made."

5.6 **Third stage:** Consider whether such an intention is consistent with the nature of the transaction as described by the label the parties put on it.

5.7 Concerning this stage Morritt VC stated that "[t]he answer is clearly in the negative". He went on to state that clause 2(v) of the Debenture charged the book debts "by way of specific charge" but that that was not the consequence of the rights and obligations granted and imposed by clause 5 (the payment of book debts into the Company's account with the Bank; the restriction of not selling, factoring, discounting or otherwise charging or assigning the same in favour of any other person or purporting to do so; and, a condition that, if the Company was called upon to do so by the Bank, execute legal assignments of such book debts and other debts to the Bank).

6 Conclusion

6.1 Morritt VC concluded as follows:

"The consequence is that the charge over book debts granted by the Company to the Bank can only have been a floating charge and the rights of the parties to this application must be ascertained accordingly."

6.2 Morritt VC therefore dismissed NatWest's application.

6.3 NatWest have been granted leave to appeal and it is expected that the appeal will be expedited in order for the matter to be clarified as quickly as possible.

This note has been produced for general information only and does not constitute legal advice. We recommend that specific advice be sought from the Louise Verrill and Will Gunston whose contact details are set out below.

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