



SECURITY ON RENTAL INCOME¹

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1. A bank takes a charge from a company on the company's rental income from real or personal property. The company goes into administration or liquidation. The administrator or liquidator wishes to use the rental income to discharge costs and expenses of the administration or liquidation, subject to providing for the prescribed part. Does the bank's charge prevent this?
2. In considering this question, this paper will examine the following.
 - a. Rights under legal and equitable mortgages on land.
 - b. Rights under a specific charge on rental income from land.
 - c. Characterisation of security on receivables as a fixed or floating charge.
 - d. Rent as the 'fruits' of a fixed charge asset.
 - e. The use of blocked accounts.
 - f. Rights under a generic charge on book debts.
 - g. Rental income from chattels.
 - h. Assignments of rental income.
 - i. The position of the liquidator or administrator.

The bank's documents

3. The bank's security will often comprise one or more of the following.
 - a. A charge by way of legal mortgage on specified land.
 - b. A specific charge on the company's rental income.
 - c. A debenture expressed to create charges on all the company's existing and future property, whether real or personal, including its receivables (meaning debts payable to the company, including any rental income).

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4. The security documents will usually provide that on default by the company the bank has the right to appoint a receiver who is to act as agent of the company with power to collect any rental income.
5. The security documents may also include provisions intended to restrict the way in which the company's rental income is handled. These may be along the following lines.
 - a. The company is to collect its receivables and pay them into an account held with the bank.
 - b. The company is to hold the receivables on trust for the bank until they are paid into its bank account.
 - c. The bank may require the company to open a bank account for collection of the receivables, including one or more separate designated accounts, blocked or trust accounts.
 - d. The company covenants not to release, factor or assign or otherwise deal with its receivables without the bank's prior consent.

For convenience, I will call these "Collection Provisions".

Rights under a mortgage by way of legal charge on land

6. Consider first the position if the bank simply has a conventional mortgage by way of legal charge on specified freehold or leasehold land owned by the company. The bank does not have a specific charge on the company's rental income, a debenture charging its receivables, nor does it have the benefit of any Collection Provisions.

(1) Controlling rent by taking possession

7. In the absence of any contrary agreement, a mortgagor in possession of land is entitled to receive and retain the income of the mortgaged property without any liability to account in law or in equity to the mortgagee.² The mortgagee

² *Fisher & Lightwood's Law of Mortgage* 14th ed. (2014) ("Fisher & Lightwood") para 29.4; *Gaskell v Gosling* [1896] 1 QB 669 (CA), 691 (Rigby LJ, whose dissenting judgment was



becomes entitled to the rents if it goes into possession. If the mortgaged property is occupied by tenants, the mortgagee goes into possession by giving notice to the tenants requiring them to pay rent to him.³ In *Moss v Gallimore*,⁴ Lord Mansfield described the position as one in which:

“... the mortgagor receives the rent by a tacit agreement with the mortgagee, but the mortgagee may put an end to this agreement when he pleases. He has the legal title to the rent ...”.

8. This has been held to be the position whether the rent is due under a lease created before or after the mortgage.⁵
9. This position is also reflected in statute. For example:
 - a. section 98 of the Law of Property Act 1925 provides that “a mortgagor for the time being entitled to the possession or receipt of the rents and profits of any land, as to which the mortgagee has not given notice of his intention to take possession or to enter into the receipt of the rents and profits thereof, may sue for such possession, or for the recovery of such rents or profits, or to prevent or recover damages in respect of any trespass or other wrong relative thereto, in his own name only, unless the cause of action arises upon a lease or other contract made by him jointly with any other person”;
 - b. in relation to mortgaged property which is the subject of a lease granted since 1 January 1996, a mortgagee in possession has a statutory right to enforce any tenant covenant or right of entry which is enforceable by the mortgagor: section 15 Landlord & Tenant (Covenants) Act 1995.
10. Once the bank goes into possession, its right to rental income relates back to the date of the mortgage deed, and therefore entitles the bank not just to on-going rental payments, but also to arrears accrued since the date of the

upheld on appeal at [1897] AC 575); *Rhodes v Allied Dunbar Pension Services Ltd* [1989] 1 WLR 800 (CA), 807D/E (Nicholls LJ).

³ *Fisher & Lightwood* para 29.8.

⁴ (1779) 1 Doug KB 279.

⁵ *Rogers v Humphreys* (1835) 4 Ad & E 299; *Re Ind, Coope & Co Ltd* [1911] 2 Ch 223, 231 - 232 (Warrington J).



mortgage deed which remain outstanding at the date on which possession is taken.⁶ But taking possession carries with it responsibilities which the bank may not be prepared to undertake.⁷

(2) Controlling rent by appointing receivers

11. In the context of mortgages, receivership developed so as to enable the secured creditor to avoid liability as a mortgagee in possession.⁸ Receivership does not cause the bank itself to be regarded as going into possession if (as is usual) the receivers act as agents for the borrower, not the mortgagee.⁹ The receivers are entitled to receive the rental income, as agents of the company, but having been appointed by the bank in exercise of the powers and remedies conferred by its mortgage, the receivers are accountable to the bank for their receipts.

(3) The effect of liquidation

12. If the company goes into compulsory liquidation, there is a statutory stay on any action or proceeding being brought or continued against the company or its property without leave of the court.¹⁰
13. The statutory stay does not require the bank to obtain leave before appointing a receiver, as this is purely a matter between the bank and receiver.¹¹ Liquidation terminates the receiver's agency for the company.¹² The receiver then acts on his own account as principal unless and until the mortgagee does anything to constitute the receiver as his agent.¹³ The termination of the

⁶ *Fisher & Lightwood* para 29.49; *Moss v Gallimore* (above).

⁷ For a discussion of the liabilities of a mortgagee in possession, see *Fisher & Lightwood* para 29.54 and following.

⁸ *Gaskell v Gosling* [1896] 1 QB 669 (CA), 691-693 (Rigby LJ).

⁹ *Rhodes v Allied Dunbar Pension Services Ltd* [1989] 1 WLR 800 (CA), 807G-H (Nicholls LJ). The agency for the company is usually expressly stated in the mortgage deed and is the statutory default position: s 109(2) Law of Property Act 1925.

¹⁰ Section 130(2) Insolvency Act 1986. In voluntary liquidation there is no automatic stay but it has been said that the company or others may apply for a stay under s 112: *Gaardsoe v Optimal Wealth Management* [2013] Ch 298 (Ch D).

¹¹ Goode, *Principles of Corporate Insolvency Law* 3rd ed (2005) para 10-28.

¹² *Gough's Garages Ltd v Pugsley* [1930] 1 KB 615, 626 (CA).

¹³ Lightman & Moss, *The Law of Administrators & Receivers of Companies*, 5th ed (2011) ("Lightman & Moss") para 15-043.



receiver's agency does not affect the receiver's right to possession of the charged property.¹⁴ If the liquidator is in possession, it seems that the liquidator's consent or a court order would be required for the receiver to take possession, not because of the statutory stay, but rather because it is a contempt to take possession from an officer of the court without permission.¹⁵

14. It is not clear whether the bank needs leave before directing a tenant to pay rent to the bank. In the context of administration, it has been held that service of a notice, even one having contractual effect, does not require leave.¹⁶ But as has been explained, notice requiring payment of rent to the bank puts the bank into possession, displacing possession by the liquidator, which requires the liquidator's consent or an order of the court, according to the cases mentioned above.

(4) The effect of administration

15. Once an administration order is made, no step may be taken to enforce security over the company's property except with the consent of the administrator, or with the permission of the court.¹⁷
16. Appointment of receivers is an enforcement remedy, which therefore requires consent or permission.¹⁸ Once appointed, it is not clear whether a receiver's agency comes to an end when the company goes into administration, as it does on liquidation. The administrator acts as agent for the company.¹⁹ It would seem curious if, notwithstanding the imposition of the statutory agency of the administrators, the receivers could continue to act as agents for the company. On this basis, it may be that the receiver loses his agency for the company but, as in the case of liquidation, continues to act in his own right. In that capacity, the receiver will continue to be entitled to collect the rental income, with a duty to account to the bank.

¹⁴ *Sowman v David Samuel Trust Ltd* [1978] 1 WLR 22, 30A (Goulding J).

¹⁵ *Re Henry Pound, Son & Hutchins* (1889) 42 Ch D 402 (CA), at 420 - 421 (Cotton LJ) and 422 (Fry LJ); *In Re Potters Oil* [1986] 1 WLR 201 at 206A (Hoffmann J).

¹⁶ *Re Olympia & York Canary Wharf Ltd* [1993] BCLC 453 (Millet J).

¹⁷ Insolvency Act 1986, Sch B1, para 43(2).

¹⁸ *Lightman & Moss* at para 15-035.

¹⁹ Insolvency Act 1986, Sch B1, para 69.



17. The position in relation to collection of rent by the bank itself as mortgagee in possession is probably no different from its position in compulsory liquidation. It would seem that consent or permission is also required before directing tenants to pay rent to the bank.²⁰ The key issue will then be whether the court would be likely to give permission. The approach which the court takes on an application for permission is discussed later in this paper.

(5) Rent outside the mortgagee's control

18. As explained above, until the bank appoints receivers or takes possession, it has no entitlement to the rental income. If at any time before the bank appoints receivers or takes possession, rent is paid and remains in an account in the name of the company, there would appear to be no basis for the bank to claim to have security on those funds so as to give it priority as against a liquidator or administrator. To fill this potential gap in its security, the bank may take an express charge on the company's rental income, as discussed below.

Rights under an equitable mortgage or charge on land

19. What difference does it make if, for any reason, the bank's mortgage takes effect as an equitable, rather than a legal, mortgage or charge? This could be the position if, for example, the security document has not been validly executed as a deed or is an unregistered mortgage or charge on registered land.²¹
20. It is doubtful whether an equitable mortgagee is entitled to possession, at least without a court order, and there is authority that an equitable mortgagee has no right to collect rental income if the land is let.²² An equitable chargee has no right to possession at all.²³
21. The principal remedy available to a bank holding an equitable mortgage or charge is to appoint a receiver. The appointment can be made without a court

²⁰ See paragraph 14 above.

²¹ *Fisher & Lightwood* para 5.14.

²² *Finke v Tranter* [1905] 1 KB 427 (Div Ct), 429 (Lord Alverstone CJ).

²³ *Megarry & Wade, The Law of Real Property* 8th ed. (2012) ("Megarry & Wade") para 25-046 & 25-050.



order if the mortgage has been executed as a deed.²⁴ Otherwise a court order is required. In principle, post-liquidation or administration, the ability of the bank to control rental income by the appointment of a receiver is likely to be subject to the same restrictions as discussed above in the case of a legal mortgagee.

Rights under a specific charge on rental income from land

22. Next consider a case where, in addition to a mortgage by way of legal charge on land, the bank has an express charge on the company's rental income from the mortgaged property. To what extent does the bank improve its position in liquidation or administration beyond that set out above? To answer this question it is first necessary to consider whether the bank's charge on rental income is created as a fixed or floating charge.

(1) Floating charges on rental income from land

23. A floating charge will usually, whether expressly or by necessary implication, permit the company to deal with the charged assets in the ordinary course of business without the consent of the charge.²⁵
24. In *Re Ind, Coope & Co Ltd*,²⁶ in addition to legal mortgages on specific properties, the plaintiffs had debentures creating floating charges on the company's other assets, present and future. The entitlement of the plaintiffs to rents from properties which were not specifically mortgaged to them was challenged by trustees acting on behalf of a bank to which the benefit of the rents had been assigned after the date of the debentures. It was argued²⁷ that the assignee took priority because:

“At the date when these debts were assigned to us they were assets of the company subject only to the floating charges. The company had power to

²⁴ *Megarry & Wade* para 25-049 & 25-050.

²⁵ *Goode on Legal Problems of Credit & Security* 5th ed (2013) (“Goode”) para 4-03 – 4-04, and *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284, 295 (Romer LJ), affirmed by the House of Lords on appeal: see [1904] AC 355.

²⁶ [1911] 2 Ch 223.

²⁷ [1911] 2 Ch 223, 228.



take the debts out of the floating charges and assign them to us, and did so. We are therefore entitled to all the arrears assigned to us ...”

25. Warrington J accepted that the assignees were entitled to the rents derived from the properties which had not been specifically mortgaged to the plaintiffs. He held:²⁸

“... the trustees of the several debenture deeds were not mortgagees in the proper sense, they had no right to go into possession, they were not the reversioners expectant upon the leases and tenancies, and they, therefore, had no right to receive the rents in arrear. With regard to the rents, therefore, that were payable in respect of property not specifically charged I think [the later assignees] are entitled to priority over the several debenture stock-holders.”

26. It follows that so long as a charge on rental income from land remains a floating charge, it offers the bank no significant additional protection.

(2) The impact of crystallisation

27. A floating charge will usually provide for crystallisation on an event of default or insolvency such as liquidation or administration.²⁹ On crystallisation, the charge becomes fixed, fastening on all assets within its scope which the company then has or subsequently acquires. Crystallisation is not retrospective, but rental income which falls within the scope of a floating charge is likely to become the subject of a fixed charge on crystallisation.
28. Nevertheless, in the context of company charges, a raft of statutory provisions dilutes the benefit which the bank would otherwise obtain from crystallisation of a charge which, at the time of its creation, was a floating charge. The relevant provisions include the following.
- a. Section 754 Companies Act 2006 applies to company debentures secured by a charge which “as created” was a floating charge. If possession is taken, by or on behalf of the holders of the debentures, of any property comprised in or subject to the charge, and the company is not at that time in the course of being wound up, the company's preferential debts are

²⁸ [1911] 2 Ch 223, 230.

²⁹ Goode para 4-31.



required to be paid out of assets coming to the hands of the persons taking possession in priority to any claims for principal or interest in respect of the debentures.³⁰

- b. Section 40 Insolvency Act 1986 applies where a receiver is appointed on behalf of the holders of any debentures of the company secured by a charge which “as created” was a floating charge. If the company is not at the time in course of being wound up, its preferential debts are required to be paid out of the assets coming to the hands of the receiver in priority to any claims for principal or interest in respect of the debentures.
- c. Section 175 Insolvency Act 1986 provides that in company winding-up, so far as the assets of the company available for payment of general creditors are insufficient to meet them, preferential debts have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the company. By section 251 Insolvency Act 1986 this means any charge which “as created, was a floating charge”.
- d. Section 176ZA Insolvency Act 1986 makes provision in company liquidation for expenses of winding up, so far as the assets of the company available for payment of general creditors are insufficient to meet them, to have priority over any claims to property comprised in or subject to any floating charge created by the company. The definition in section 251 again applies.
- e. Section 176A Insolvency Act 1986 makes provision in company liquidation, administration and receivership for a prescribed part of the company's net property to be made available for the satisfaction of unsecured debts and to be paid out of any property comprised in or subject to a floating charge. The definition in section 251 again applies.
- f. Section 245 Insolvency Act 1986 provides for a floating charge given by an insolvent company within the 12 months prior to the onset of insolvency to be invalid except as to new value.

³⁰ In *Re Oval 1742 Ltd* [2008] BCC 135 it was held that a bank had taken possession for this purpose when it received proceeds from a sale of a charged asset which was released from the bank's charge.



- g. Para 70 of Sch B1 Insolvency Act 1986 allows company administrators to dispose of assets subject to a floating charge without leave of the court. By paragraph 111(1), for this purpose floating charge means a charge which is a floating charge on its creation. Para 99(3)(b) of Sch B1 provides for a former administrator's remuneration and expenses to be payable in priority to any security to which para 70 applies.
29. Any improvement in the bank's position by taking a floating charge on the company's rental income from land is diluted or potentially removed altogether by these provisions, depending how the numbers stack up. Regardless of subsequent crystallisation, the holder of a floating charge cannot prevent a liquidator or administrator from applying rental income to the prescribed part and to discharge costs and expenses of the administration or liquidation.

(3) Fixed charges on rental income from land

30. In contrast, a charge on rental income which is created as a fixed charge is not within the scope of the above statutory provisions. The position of a bank with the benefit of such a fixed charge would therefore be improved. For example, if the company has funds in an account which represent rents paid by its tenants, a fixed charge should give the bank priority as against a liquidator or administrator even if the bank has not appointed receivers or taken possession.

Characterisation of security over receivables as a fixed or floating charge

31. It can therefore be critical to determine whether a charge on the company's rental income has been effectively created as a fixed or floating charge.
32. The modern approach to determining whether security provided by a company over its receivables is a fixed or floating security is set out in the decision of the House of Lords in *In re Spectrum Plus Ltd (in liquidation)*.³¹ That decision confirms that the key criterion for deciding whether the charge is fixed or floating is not whether the charge is expressed to be fixed, but the degree of control in fact exercised by the chargee over the charged assets. Following the

³¹ [2005] 2 AC 680.



approach of the Privy Council in *Agnew v Commissioner of Inland Revenue*,³² it was held in *Spectrum* that a charge on book debts contained in the bank's debenture was created as a floating charge, not as a fixed charge, because once the debts in question were collected and paid into the company's current account, the debenture placed no restriction on the use the company could make of the balance in the account, since it was not a blocked account (a concept discussed in more detail below).

Rent as the “fruits” of a fixed charge asset

33. In *Spectrum* the bank sought a declaration that its debenture “created a fixed charge over the company's book debts and the proceeds thereof”.³³ The funds in issue comprised £113,484 which the liquidators of the company had collected in respect of book debts.³⁴ No more detailed consideration seems to have been given to the derivation of the funds.
34. It is possible that a different approach might be taken in circumstances where the receivables comprise income (such as rent) derived from an asset which is itself charged to the bank. Support for this approach can be found in cases which have held that where a charge has been created on leases of specific chattels, the fact that the chargor company was to receive and use the rent payable under the leases until the chargee chose to intervene, did not cause the charges on the leases or the rents flowing from them to be floating rather than fixed.³⁵ As Lord Nicholls stated in *Re Atlantic Computer Systems Ltd*³⁶ “A mortgage of land does not become a floating charge by reason of the mortgagor being permitted to remain in possession and enjoy the fruits of the property charged for the time being.”
35. There are significant reasons to doubt whether a court would now follow the *Atlantic* cases. Although they have not been overruled, they were decided before the decisions of the Privy Council in *Agnew* and the House of Lords in

³² [2001] AC 710.

³³ [2004] Ch 337, [6].

³⁴ [2004] Ch 337, [14]; [2005] 2 AC 680, [84]-[85].

³⁵ *Re Atlantic Computer Systems Ltd* [1992] Ch 505 (CA); *Re Atlantic Medical Ltd* [1993] BCLC 386 (Vinelott J).

³⁶ [1992] Ch 505, 534.



Spectrum. Until those two decisions there was a significant body of opinion and practice which supported the characterisation of many charges (especially on receivables) as fixed charges which would now be regarded as floating. For that (and other) reasons, the reasoning of the *Atlantic* cases has been doubted by many commentators. For example, in his article *Charges over Book Debts: a Missed Opportunity*,³⁷ Professor Goode expressed the view that the *Atlantic Computer* decision was wrong because in his view the fact that the chargor was free to use the proceeds of the rentals in the ordinary course of business was only consistent with the charge being floating. Similarly, writing in *Insolvency Intelligence*,³⁸ Gabriel Moss QC expressed the view that the Court of Appeal's approach in *Atlantic Computer* "is erroneous", and writing in the same publication, Fidelis Oditah described the *Atlantic* cases as "odd decisions of questionable application".³⁹

36. Judicial treatment of the *Atlantic* cases has varied. *Atlantic Computer* was referred to by Jonathan Parker J at first instance in holding security fixed, not floating, in *Royal Trust Bank v National Westminster Bank plc*⁴⁰ and *In re Cosslett (Contractors) Ltd*.⁴¹ But in appeals in both cases the security was held to be floating, not fixed, without referring to the *Atlantic Computer* case.⁴² The dictum of Lord Nicholls in the *Atlantic Computer* case which has been quoted above, was applied in *Arthur D Little Ltd v Ableco Finance LLC*⁴³ in holding a charge on shares to be fixed not floating. In the *Spectrum* case the Court of Appeal regarded *Agnew* as conflicting "indirectly" with the *Atlantic* cases.⁴⁴ *Atlantic Computer* was cited in argument in the appeal to the House of Lords in *Spectrum*, but their lordships (including Lord Nicholls himself) made no reference to it.

³⁷ (1994) 110 LQR 592.

³⁸ Vol 8 (April 1995) p 25.

³⁹ Vol 14 (July 2001), p 53; see also *Corporate Finance Law, Principles & Policy* 1st ed. (2011, reprinted 2014) p 253 and the articles cited at footnote 280.

⁴⁰ [1996] 2 BCLC 682.

⁴¹ [1997] Ch 23.

⁴² *Royal Trust Bank v National Westminster Bank plc* [1996] 2 BCLC 682 at 699ff, *In re Cosslett (Contractors) Ltd* [2003] 495 (CA), and *In re Cosslett (Contractors) Ltd* [2002] 1 AC 336 (HL).

⁴³ [2003] Ch 217, 237C.

⁴⁴ [2004] Ch 337, [54].



37. At least in the context of mortgages on land, no one seems to doubt Lord Nicholls' dictum in *Atlantic Computer*. A similar (if not identical) principle has since been applied to the proceeds of sale of land in *Buhr v Barclays Bank plc*.⁴⁵ In that case Arden LJ (with whom the other members of the Court of Appeal agreed) rejected a submission that the principles in *Agnew* applied to determine the nature of a charge on the proceeds of sale of mortgaged land. Arden LJ held⁴⁶ that "in that situation, the law treats the mortgagee as entitled to the property which represents the mortgaged property. That conclusion does not depend on the indivisibility of property from its proceeds, but rather on the derivation of the proceeds of sale. The authorities on book debts therefore neither assist in this case or undermine the principle which I have stated".
38. Where the bank has the benefit of a charge on the land which generates the rental income, it may be open to the bank to argue that the rental income represents the fruits of the mortgaged property and the *Spectrum* line of cases has no application.⁴⁷ There appears to be no reported case which considers this argument in the context of rental income derived from mortgaged land.
39. There is nevertheless a risk that a court would decide that the principles explained in *Spectrum* do apply to determine the proper characterisation of the bank's charge on rental income, at least for the purpose of determining whether that charge was fixed or floating at the time of its creation. The argument might be developed as follows.
- a. As explained above, even with the benefit of a mortgage on the specific land which generates the rental income, the bank would not have any right to the rental income until it took possession.
 - b. On that basis, any right which the bank asserts to rental income when a charge is created and before taking possession, cannot flow from its mortgage or charge on the land but can only arise as a matter of simple contract (in which case it is not a security at all) or from a separate charge on rental income or book debts.

⁴⁵ [2001] EWCA Civ 1223.

⁴⁶ At [43].

⁴⁷ See the discussion of this issue in *Corporate Finance Law, Principles & Policy* 1st ed. (2011, reprinted 2014) at pp 251 – 252.



- c. The *Spectrum* principles apply to determine whether such a charge on rental income or book debts is fixed or floating.

Blocked accounts

40. Now consider the position where the bank's charge on rental income includes Collection Provisions of the type mentioned earlier, including provision for use of a blocked account. This may assist the bank in establishing that its charge is fixed and not floating. But there remains doubt as to how to operate a blocked account for this purpose.

- a. The editor of *Goode* suggests⁴⁸ that only a total prohibition of all dealings and withdrawals without permission is likely to be enough to create a fixed charge.
- b. For an example of this see *Re Harmony Care Homes Ltd.*⁴⁹ In that case the debenture holder was a third party (not the bank holding the company's account). The court was satisfied that the debenture holder's charge on book debts represented by monies in a bank account was a fixed charge because "from the opening of the account ... the Company could not make and did not make any use of the monies paid into the account without [the debenture-holder's] written instructions ...".⁵⁰ The court also confirmed that the company's ability to deal with its book debt realisations has to be considered at the time the debenture was granted.⁵¹ It is irrelevant that some months after the execution of the debenture, the company is restricted from freely using the proceeds of the book debts as a result of the setting up of a blocked account.⁵²
- c. In the course of his judgment in the Court of Appeal in *Spectrum*,⁵³ Lord Phillips MR commented that "it would seem beyond dispute that a

⁴⁸ Professor Louise Gullifer, *Goode* para 4-23.

⁴⁹ [2009] EWHC 1961 (Ch).

⁵⁰ At [25].

⁵¹ At [18].

⁵² At [19].

⁵³ [2004] Ch 337, [99].



requirement to pay book debts into a blocked account will be sufficient restriction to render a charge over book debts a fixed charge, even if the chargor is permitted to overdraw on another account, into which from time to time transfers are made from the blocked account.” However, in the House of Lords Lord Walker commented⁵⁴ that this suggestion “although no doubt appropriate and efficacious in some commercial contexts, may not provide a simple solution in every case”.

- d. The editor of *Goode* suggests⁵⁵ that “If such a structure is to stand a chance of being characterised as a fixed charge, the consent of the chargee to transfers to the second account would have to constitute independent acts of will: a blanket consent will not suffice. This might be achieved by providing that the chargee was under no obligation to consent to transfers, although it might be difficult to argue that such a provision represented the true intention of the parties if the chargee did habitually consent and such consent was relied upon by the chargor. Further, the agreement should provide for the amount left in the first account not to be reduced below a certain level” (which the editor suggests should relate to the amount of the outstanding secured debt).
- e. The editor of *Goode*⁵⁶ suggests two possible alternatives. First, a structure comprising “a fixed charge covering the receivables and proceeds up to a certain amount, the rest being subject to a floating charge. When the proceeds in the account exceeded that amount, the surplus could be withdrawn and placed in another account. There are however, two problems with this structure. First, a chargee will usually want a fixed charge over *all* the chargor’s receivables and all the proceeds. Secondly, there is the problem of identifying the receivables which are subject to the charge, and (lesser) problems of identifying part of a bank account.”
- f. The other alternative suggested in *Goode*, is “where the charge agreement or another agreement, provides that the proceeds of the debts should be disposed of in a particular way, including but not limited to the repayment of the secured loan. Sometimes called a ‘payment waterfall’. Although,

⁵⁴ [2005] 2 AC 680, [160].

⁵⁵ Para 4-29.

⁵⁶ Also para 4-29.



given the seemingly absolute nature of the judgments in *Spectrum* discussed above, there is a danger that this would amount to 'consent in advance' to dispositions, and therefore to the charge being characterised as floating, it is submitted that the better view is that it is possible, if the clause is prescriptive enough as to the destination of the dispositions, for such a clause to give the charge sufficient control over the proceeds for the charge to be characterised as fixed."

- g. Whichever alternative is used, the editor of *Goode* stresses⁵⁷ that the restrictions must be operated in practice, otherwise "the court is likely to take the view either that the contractual provisions were mere camouflage or that they have been waived by the creditor."
41. Whilst it may be possible to use one or other of the above methods to achieve a fully effective fixed charge on receivables, the extent to which this deprives the company of ready access to funds which represent its life-blood, frequently deters banks from insisting that such restrictions are operated in practice. In that event, in any subsequent insolvency, the bank may concede that its charge on receivables, although expressed to be a fixed charge, was in fact created only as a floating charge.

Rights under a generic charge on book debts and other receivables

42. Consider next the position where the bank's charge on rental income is not set out in a separate security document or within a specific clause charging rental income, but is simply part of a generic clause within a security deed, such as a debenture which purports to create a fixed charge on the company's book debts and other receivables.
43. In such a case the court would first need to be satisfied that on its true interpretation, the wording of the charging clause is apt to cover rental income. But assuming it is, there remains a risk that the charge might be held to be floating, even if the rental income, had it been separately charged, could have been made the subject of a fixed charge. This is the result of the so-called 'all

⁵⁷ [2005] 2 AC 680, [160].



or nothing' approach adopted at first instance in *Re ASRS Establishment Ltd*.⁵⁸ There Park J concluded that a charge on company funds held by a stakeholder in an escrow account was floating, not fixed. In reaching that conclusion he referred to the fact that the charge was expressed as a generic charge "on all books debts, bank account credit balances and other debts and claims" and was not specific to the escrow account. On that basis, he reasoned⁵⁹ that the charge on the escrow account could only be a fixed charge if the charge on "other debts and claims" was also a fixed charge, which was a question to be addressed "by reference to 'other debts and claims' generically, and not by concentrating on the escrow account". On appeal, Walker LJ preferred to leave this point open. He said:⁶⁰ "I would not accept the 'all or nothing' view without some reservations and I do not think it is necessary to express a final view on the point in order to decide this appeal." Instead he upheld Park J's decision on the more conventional ground that the company could not be prevented from using the proceeds of the escrow monies in the ordinary course of business. Nevertheless, the 'all or nothing' approach has since been adopted in at least one first instance decision.⁶¹ The upshot is that a generic clause creating a charge on all book debts and receivables carries a greater risk that it will be regarded as floating rather than fixed, unless the test of control is satisfied in relation all of the assets which potentially fall within its scope.

Rental income from chattels

44. The focus of the discussion set out above has been on mortgages and charges of, and rental income from, real property. Where the charged property comprises chattels (such as plant and machinery) rather than land, broadly equivalent principles can be expected to apply. Mortgages on chattels may also be legal or equitable.⁶² In practice chattels are more likely than land to be required to be used, consumed or otherwise dealt with in the course of the company's business. In contrast with land, therefore, such assets are more likely to be the subject of floating rather than fixed security. Although the

⁵⁸ [2000] 1 BCLC 727 (Park J).

⁵⁹ At 736h.

⁶⁰ [2000] 2 BCLC 631, 639i.

⁶¹ *Re Beam Tube Products Ltd* [2006] BCC 615, [33] (Blackburne J).

⁶² *Fisher & Lightwood* para 16.1.



Atlantic Computer cases suggest that a rental income stream from chattel leases may nevertheless be considered a fixed charge asset, for the reasons already discussed above, the continuing authority of those cases post-*Spectrum* is doubtful.

Security Financial Collateral Arrangements

45. The discussion set out above assumes that any charge on which the bank relies is not a security financial collateral arrangement for the purpose of the *Financial Collateral Arrangements (No 2) Regulations 2003*⁶³ (“FCARs”), to which different considerations apply. In very broad terms whether a charge on sums paid into a bank account falls within the scope of the FCARs is likely to depend on whether it is regarded as within the chargee’s “possession or control”, an issue not dissimilar to the one which arises in determining whether a charge is fixed or floating. So “while there is no necessary connection between the test for whether a charge is fixed and whether it is a security financial collateral arrangement, it is likely that most fixed charges over financial collateral will fall under the FCARs, while many floating charges will not”.⁶⁴

Assignments of rental income

46. An alternative security mechanism which may overcome the fixed/floating charge classification dilemma is for the bank to incorporate into its security documentation an assignment of the company’s rental income.
47. The distinction between assignments and charges is considered in *Bexhill UK Ltd v Razzaq*.⁶⁵ The Court of Appeal confirmed that an effective assignment of a debt differs from a charge in that it transfers legal or beneficial ownership to the assignee.⁶⁶ Whether a particular instrument creates an “absolute” assignment or an assignment “by way of charge only” is a question of

⁶³ SI 2003/3226.

⁶⁴ *Goode* para 4-10; and see *Gray v G-T-P Group Ltd* [2010] EWHC 1772 (Ch) (Vos J).

⁶⁵ [2012] EWCA Civ 1376.

⁶⁶ At [44].



construction of the relevant instrument taken as a whole.⁶⁷ So where a debenture included a provision by which the company “assigns and agrees to assign absolutely in favour of [a bank] all of its rights, title, interest and benefit in the Receivables”, this was held to be an assignment, not a charge, and to be sufficient to transfer ownership of all existing and future Receivables, in the case of future Receivables as soon as they came into being.⁶⁸ The deciding factor was that the debenture obliged the company to give a notice of assignment to other parties to “Relevant Contracts” and the terms of the notice was to the effect that “all rights and remedies in connection with” any agreement made between Bexhill and its customers and “all proceeds and claims arising from” such an agreement were assigned.⁶⁹

48. It would seem that an assignment of rental income would only be vulnerable to challenge as a floating charge if it was to be held that properly construed it amounted to an assignment by way of charge rather than an absolute assignment. Commenting on “Security distinguished from purchase” the editor of *Goode* states:⁷⁰

“Provided that the transaction is genuine and not a sham, the courts will uphold it as a sale,^[20] even if the parties use commercial language which to the legal mind would suggest a loan on security.

[20] There appears to be no reported case in which a purported sale of receivables has been struck down as a disguised loan on security, but the cases on chattel mortgages disguised as an outright sale would be equally in point here.”

49. An assignment can be expressed in broad terms without losing its status as an assignment. In *Razzag* the wording was both in the broad terms mentioned above, but also specifically referred to Bexhill assigning and agreeing to assign absolutely in favour of Barclays “all of its rights, title, interest and benefit in and to each Relevant Contract”. Relevant Contract was defined as meaning “each of the Retail Financier Assignments and the Bexhill Facility Agreements as may be in existence from time to time”. The debenture expressly provided for notice

⁶⁷ At [45].

⁶⁸ At [52].

⁶⁹ At [55].

⁷⁰ Para 3-01.



of assignment (in a pre-agreed form) to be given in relation to each “Relevant Contract.”⁷¹

50. As the *Razzaq* case also demonstrates, the fact that an assignment is expressed to be by way of security for a loan does not of itself prevent it being absolute and not therefore in the nature of a charge. The distinction does not turn on whether the assignment (if effective) is legal or only equitable. An assignment may be an absolute assignment but because notice of the assignment is not given to the debtor, it remains equitable only. It will become a legal assignment when notice is given.⁷²
51. Nor does the fact that an assignment does not contain any express provision for re-assignment, prevent it from being an assignment by way of security. In *Hughes v Pump House Hotel Company Ltd*⁷³ all money due under a particular building contract was assigned absolutely to Lloyds Bank by way of continuing security for all moneys due on a bank account. The assignment contained no express provision for re-assignment. Cozens-Hardy LJ held⁷⁴ that there was no need for such an express provision because “Where there is an absolute assignment of the debt, but by way of security, equity would imply a right of reassignment on redemption”. It follows that there does not need to be an express provision for re-assignment, if the assignment is expressed to be by way of security.
52. Absent agreement to the contrary in the facility agreements made between the bank and the company, justification is not required to serve notice converting an equitable assignment into a legal assignment. Nor would it seem that doing so would contravene any insolvency imposed moratorium. It has been held that service of a contractual termination notice or notice making time of the essence is not caught by the moratorium imposed on proceedings against a

⁷¹ [2012] EWCA Civ 1376, [14] – [16].

⁷² See to this effect *Razzaq* at [52]: “The wording of cl 3.1.1 is simple and clear. On the face of it the clause assigns absolutely to Barclays all existing Receivables. (Whether they will be legal assignments within s 136 LPA 1925 will depend on whether express notice in writing has been given to the debtor in each case.)”

⁷³ [1902] 2 KB 190 (CA).

⁷⁴ At 197.



company in administration.⁷⁵ Service of notice of assignment which merely converts an assignment into a legal assignment is a purely administrative step, not a form of enforcement which might otherwise be caught by the moratorium.

The position of a liquidator or administrator

53. A liquidator or administrator will need to take his own advice as to whether rents being paid to the company fall within the scope of the bank's security. If there is a dispute as to whether rents represent a fixed or floating charge asset, the issue may be referred by the office-holder to the court for directions.⁷⁶ It has also been held that if administrators wish to make use of another's property for the purposes of administration and cannot agree terms, they should seek directions from the court.⁷⁷ Alternatively, the bank may apply to court for permission to enforce its security.⁷⁸

(1) Leave to enforce security in compulsory liquidation

54. As already noted,⁷⁹ it has been held that possession of assets by a liquidator cannot be displaced without consent or a court order. But the cases indicate that as between a mortgagee and its receivers, on the one hand, and a liquidator, on the other, the mortgagee and receivers would be entitled to leave as of right.⁸⁰ It is no answer that the charged property could be realised by the liquidator more cheaply and no less effectively. The mortgagee is under no duty to refrain from exercising his rights merely because to do so may cause loss to the company or its unsecured creditors.⁸¹

⁷⁵ *Re Olympia & York Canary Wharf (No 1)* [1993] BCC 154, more recently applied in *Re Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch).

⁷⁶ Insolvency Act 1986, s 112(1) (voluntary liquidation), s 168(3) (compulsory liquidation), & Sch B1 para 63 (administration).

⁷⁷ *Barclays Mercantile Business Finance Ltd v Sibec Developments Ltd* [1992] 1 WLR 1253, 1259.

⁷⁸ Insolvency Act 1986, s 130(3) (compulsory liquidation), Sch B1 para 43(2) (administration).

⁷⁹ See paragraph 3 above.

⁸⁰ See footnote 15 above.

⁸¹ *In re Potters Oil Ltd* [1986] 1 WLR 201, 206B-C (Hoffmann J); *Lightman & Moss* para 15-035.



(2) Permission to enforce security in administration

55. The *Atlantic Computer* case⁸² confirms that in response to a request for consent to proceed to enforce security, administrators must act reasonably, responsibly and speedily, and they must not use the moratorium as a bargaining counter in negotiations with the party claiming to be a secured creditor. The Court of Appeal stressed that great weight should be given to proprietary interests and administration should not be used to benefit unsecured creditors at the expense of those with proprietary rights. But the onus is on the applicant seeking permission to enforce his security to show it is a proper case for permission to be given. Where the security is disputed, the court must be satisfied that the applicant has a seriously arguable case that it is secured.
56. Where a secured creditor, such as a bank with a charge on rental income, is making the application, a key consideration is likely to be whether there is a possibility, if not a probability, that the secured creditor will be repaid in full from its security within a reasonable period of time, see *Royal Trust Bank v Buchler*.⁸³ In that case the court was satisfied that the bank was likely to be repaid in full and refused consent mainly because appointment of a receiver would increase costs and reduce the net proceeds. But the court imposed a condition that the administrator was to report back to the court in 2 months time if the property had not been sold.
57. Where rent is only just sufficient to cover administration expenses, two key considerations may well be whether the Bank debt is ultimately likely to be repaid (for example from a sale of the mortgaged property) and the comparative costs of administration and receivership.

Conclusions

58. In practical terms until enforcement or insolvency it is difficult to see who might mount a challenge to the efficacy of any charge on rental income held by a bank. It would not usually be in the interests of the company to do so before

⁸² [1992] Ch 505.

⁸³ [1989] BCLC 130, 135f (Peter Gibson J).



enforcement. Often the point is only taken if the company goes into a formal insolvency process.

59. Reverting back to the question posed at the start of this paper (whether the bank's security prevents the office-holder from treating the company's rental income as floating charge assets from which they can discharge costs and expenses of the administration, subject to providing for the prescribed part), and drawing the threads together, a simple answer may be: yes, if the bank's charge on the rental income is created and effective as a fixed charge. But as discussed above, the question gives rise to a variety of other considerations which, in summary, include the following.

- a. If the bank has the benefit of a legal mortgage on the specific land which generates the rental income, it is in principle entitled to the benefit of the rental income either indirectly by appointing receivers or by asserting its right as mortgagee in possession to receive payment of the rental income from the tenant. If the bank has only an equitable mortgage or charge, receivership is the likely remedy. In either case, a liquidator is unlikely to prevent the bank taking the benefit of the rental income, but an administrator might do so (para 6-21 above).
- b. If the bank has no more than a floating charge on the rental income, it will be subject to various statutory provisions which dilute its priority, including the right of the office-holder to have recourse to the rental income to discharge costs and expenses of the administration, subject to providing for the prescribed part. For this purpose what matters is the characterisation of the bank's charge at the time of its creation. Subsequent crystallisation from floating to fixed charge makes little practical difference (para 22-30 above).
- c. Whether a bank's charge on a company's receivables is properly regarded as fixed rather than floating is likely to turn on the degree of control which the bank exercises over the rental income (para 31-32 above).
- d. A possible argument exists that if the bank has a charge on land from which the rental income is derived, the bank is entitled to the rental income



as representing the fruits of the charged asset, irrespective of the degree of control which the bank exercises over the rental income. But there are persuasive counter-arguments (para 33-39 above).

- e. The operation of a blocked account to receive rental income can create sufficient control to establish the bank's charge as fixed rather than floating. But the precise nature of any right of access which the company is given to funds in the blocked account needs to be carefully considered (para 40-41 above).
- f. The charge needs to be suitably expressed. A generic charge on receivables could be more susceptible to challenge (paras 42-43 above).
- g. Similar principles are likely to apply to charges on rental income from chattels (para 44).
- h. Security financial collateral arrangements are subject to a different statutory regime (para 45).
- i. An alternative mechanism by which the bank may obtain security on rental income and avoid classification as a floating charge, is for the bank to take an assignment (para 46-52 above).
- j. A dispute between the bank and office-holder as to the correct characterisation of the bank's charge might be resolved on an application by the office-holder to the court for directions, or on an application by the bank for permission to enforce its security. In compulsory liquidation the bank is likely to get permission to enforce. Whether the bank may do so in administration will involve the court carrying out a balancing exercise (para 53-57 above).

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