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## ***Re Avanti Communications Limited (in administration) – evolution of the control required for a fixed charge***

The High Court recently issued its ruling in the matter of *Re Avanti Communications Limited (in administration)*<sup>1</sup>. It is the first major case since the pivotal 2005 House of Lords decision of *Re Spectrum Plus*<sup>2</sup> to examine the characteristics of fixed and floating charges.

### **Key points**

- *Re Avanti Communications* suggests that for a charge to take effect as a fixed charge, there does not need to be a complete prohibition on the chargor dealing with the charged assets.
- Carefully worded exceptions to a complete prohibition on disposal of certain assets – which are very commonly negotiated by borrowers in finance documents – are not necessarily inconsistent with a fixed charge.

### **However:**

- the assets to which any permitted disposal regime applies should not form part of the chargor's circulating capital (or, to put it another way, should not be assets which the chargor needs to sell as part of its ordinary business); and
- under the terms of any permitted disposals regime in the security documents the chargor's ability to deal with the charged assets should be "*materially and significantly*" limited, such that the chargee retains "*very significant control*".

Otherwise, the draughtsperson may unintentionally create a floating charge.

### **What is the difference between a fixed charge and a floating charge?**

Upon its creation, a **fixed charge** immediately attaches to (or "encumbers") property which is capable of being definite and ascertained and affords the security holder proprietary rights in those assets. Although with a fixed charge ownership and possession of the relevant charged assets remains with the chargor, the key characteristic of a fixed charge is that the chargee exercises a certain level of control over the charged asset. Preventing the chargor from freely disposing of assets subject to a fixed charge in the ordinary course of the chargor's

business is therefore crucial to the nature of a fixed charge.

By contrast, upon its creation, a **floating charge** will hover (or "float") above a shifting pool of assets, until such time as an event occurs which causes the floating charge to "crystallise". Crystallisation can occur at law if an event occurs which is incompatible with the chargor continuing to trade (e.g. the winding-up of the chargor), if the chargee intervenes to take control of the charged assets or, if the security document provides for it, upon notice following the occurrence of certain events. When the floating charge crystallises, it will then attach to all

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<sup>1</sup> [2023] EWHC 940 (Ch)

<sup>2</sup> [2005] UKHL 41

the assets in existence and subject to the charge at the time.

Until a floating charge crystallises, the chargor is also free to deal with the charged assets and the consent of the chargee is not required before the assets subject to the floating charge can be disposed of. Therefore, a chargor's business may continue as normal. Consequently, floating charge security lends itself well to assets that fluctuate and circulate within a business (such as stock, receivables and cash in current accounts). Indeed, it would be difficult for a lender to take a fixed charge over these assets because the level of control that the lender would need to exercise to achieve a fixed charge would stifle the very ability of the borrower to run its business<sup>3</sup>.

### Why does it matter whether a charge is fixed or floating?

Whether a charge takes effect as a fixed or floating charge will often be very important to a secured creditor.

If the relevant secured creditors have not agreed to vary the default position via an intercreditor agreement, upon the insolvency of a chargor which is an English company, a fixed charge holder will rank ahead of the holder of a floating charge. English insolvency law dictates that the proceeds of realisations must be distributed in a set order of priority and debts secured by fixed charges and mortgages rank at the top of the waterfall.

Crucially, the holder of a floating charge will receive nothing from floating charge realisations until amounts owed to fixed charge holders have been satisfied, the general costs of the insolvency process (which can be substantial) have been met, the claims of preferential creditors have been paid and the "prescribed part" (being a ring-fenced sum of up to £800,000 set aside to satisfy unsecured claims from floating charge recoveries) has been set aside.

In *Re Avanti Communications* the Joint Administrators and the company applied to the court to determine whether the assets in question were

subject to fixed or floating charges, as the characterisation of the charges had a bearing on the amount payable to creditors. If the charges were found to be fixed in nature, the secured creditors could recover the full amount owed. However, if the charges were found to be floating, then a portion of the proceeds would be disbursed to HMRC (as preferential creditor) and to unsecured creditors (up to the prescribed part of £800,000), ahead of the floating charge holder.

Under English insolvency law there is also usually a 12-month "hardening period" for floating charges, other than for the purpose of securing "new" money (extended to two years if the security is granted to a connected party). A court may set aside a floating charge to the extent it does not secure new money on the application of an administrator or liquidator of the chargor if the floating charge was granted within the hardening period, and the chargor was insolvent at the time of granting the security, or as a result of giving it. This issue does not arise with fixed charge security.

Even outside insolvency (and, again, assuming no overriding intercreditor agreement is entered into) the default position is that fixed charges enjoy priority over subsequent fixed and floating charges, and unknown prior floating charges. However, floating charges rank behind prior fixed and floating charges and may rank behind subsequent fixed charges.

### Determining whether a charge is fixed or floating post-*Re Avanti Communications*

In *Re Avanti Communications* the judge undertook a comprehensive exploration of the distinctions and subtleties between fixed and floating charges, including the degree of control necessary to establish a legitimate fixed charge over the relevant assets.

The key issues discussed are set out below in the context of the two-stage enquiry<sup>4</sup> which the court will conduct when determining whether a charge is fixed or floating in nature.

<sup>3</sup> The seminal description of a floating charge was provided by Romer LJ in *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284. Romer J considered a floating charge to have three characteristics and, if it had all three, it would be a floating charge: (1) it is a charge on a class of assets of a company present and future; (2) the class of assets is one which, in the ordinary course of the business of the company, would be changing from time to

time; and (3) the charge contemplates that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets subject to the charge.

<sup>4</sup> Paragraph 32 of *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28

## The First Stage: Construe the charging instrument

The court must first construe the charging instrument to determine the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. In *Re Avanti Communications*, the judge looked at various issues as part of the First Stage:

- **Were the relevant assets within the scope of the charging clause in the security documents?** In *Re Avanti Communications*, the judge was satisfied that they were.
- **What security did the parties intend to create?** At the First Stage the court is fundamentally concerned with the nature of the rights and obligations the parties intended to create. Therefore, the labels used by the parties to denote their rights and obligations (e.g. "fixed" and "floating") are relevant at the First Stage as a guide to what type of security the parties objectively intended to create.
- **What is the nature of the charged assets?** At the First Stage the nature of the relevant charged assets may be taken into account. A distinction often drawn in the authorities is between a chargor's circulating capital and its non-circulating capital, on the basis that "*compliance with the terms of a fixed charge on the company's circulating capital would paralyse its business*"<sup>5</sup>.
- **What is the nature of the chargor's business?** The judge in *Re Avanti Communications* confirmed that regard may also be had to the nature of the business of the chargor when construing the rights and obligations created under the contractual documentation. So, if the assets in question form part of a fluctuating body of assets which change from time to time in the ordinary course of the company's business, this would indicate that the parties had intended to create a floating (rather than fixed) charge.
- **What is the nature of the contractual restrictions and permissions on disposals of charged assets?** In *Re Avanti Communications*, in assessing the nature of the contractual restrictions and permissions on disposals of the charged assets the judge had to construe "*complex and detailed documents, which are not easily summarised*". Under the documents it was clear that the chargor had the ability to deal with the relevant assets. However, this ability was "*materially and significantly*" limited and the opportunities to deal with the assets applied only in particular sets of circumstances. Crucially, the contractual provisions "*provided no opportunity for the Company to dispose of the Relevant Assets or any of them in the ordinary course of its business, by which I mean the ordinary course of the Company's trading*"<sup>6</sup>.
- **Is post-contractual conduct relevant?** The judge in *Re Avanti Communications* confirmed that, for the purposes of the First Stage, post-contractual conduct is generally irrelevant and inadmissible. However, he did observe that some academics have noted that if a stipulation in the charging instrument is not adhered to in practice, the agreement may be held to be a sham and characterised as a floating charge<sup>7</sup>.

<sup>5</sup> Paragraph 7 of *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28

<sup>6</sup> Paragraph 123.

<sup>7</sup> Paragraph 4-22 of Goode & Gullifer on Legal Problems of Credit and Security (Seventh Edition).

## The Second Stage: Characterise the charge

The critical question for the court when categorising (or characterising) the charge at the Second Stage is whether the rights and obligations in respect of the relevant assets are consistent, as a matter of law, with fixed charge or floating charge security.

- **Intentions of the parties and labels used are not relevant at the Second Stage:** Unlike at the First Stage, at the Second Stage the characterisation of the charge does not depend upon the intention of the relevant parties, or the label which the parties have attached to the relevant instrument of the charge.
- **Who has control of the assets?** A critical question "*if not the critical question*<sup>8</sup>" at the Second Stage is who has control of the relevant assets as between chargor and chargee? On this key issue, Mr Justice Edwin Johnson made a number of observations in *Re Avanti Communications*:
  - **Total prohibition of dealings with the charged asset is not essential for a fixed charge – a more nuanced approach is relevant:** The law has not reached the point where only a total restriction on any disposal of charged assets by the chargor without the consent of the chargee is sufficient to create a fixed charge. Rather, existing case law supports a more nuanced approach, which depends on a number of different factors being taken into account.

These factors include:

- **Does the Company have the ability to deal with the charged assets in the ordinary course of its business?** In *Re Avanti Communications* the judge considered that the restrictions on disposals of the charged assets in the security documents "*gave to the chargees of the charge very significant control*". He said "*The essential point, as it seems to me, is that the Company was not free to deal with the Relevant Assets. Its freedom to deal with the Relevant Assets was materially and significantly limited. Putting the matter another way, it seems to me that the scheme of restrictions in the Security Documents gave the Company no ability to deal with the Relevant Assets in the ordinary course of its business*<sup>9</sup>".
- **What is the nature of the relevant assets? Crucially, could they be said to be the circulating capital or fluctuating assets of the chargor?** The judge in *Re Avanti Communications* observed that the caselaw on fixed and floating charges refers to the circulating capital or fluctuating assets of a company, which the company uses in its ordinary trading cycle. He said "*If the chargor is left free to deal with this circulating capital, the result is a floating charge. In the case of a charge over a company's circulating capital, one would normally expect that charge to be a floating charge, because otherwise the control over the circulating capital given to the chargee by a fixed charge would, or might create commercial problems for the business of the company*<sup>10</sup>".

In *Re Avanti Communications*, the secured assets comprised a HLAS-3 satellite, certain equipment used in the operation of network and ground station facilities, certain satellite network filings and certain ground station licences issued by Ofcom. The judge did not consider these assets to be the circulating capital or fluctuating assets of the chargor. Instead, the judge saw the relevant assets as being the tangible and non-tangible infrastructure owned by the Company, which was used to generate the sources of the Company's business income. The relevant assets did not need to be sold themselves to generate income and, indeed, were all assets which were inherently difficult to transfer.

<sup>8</sup> Paragraph 41 of *Re Avanti Communications*.

<sup>9</sup> Paragraph 125 of *Re Avanti Communications*.

<sup>10</sup> Paragraph 112.

## Conclusion

The *Re Avanti Communications* decision has undeniably shifted the dial on the degree of control a fixed charge holder must exercise over charged assets if it wishes to maintain a fixed charge. It is now clear that a complete prohibition on the ability of the chargor to deal with charged assets is not required for the court to uphold the existence of a fixed charge.

However, the judge did not consider it to be "*sensible or feasible to try to identify the location of the point on the spectrum of possibilities where a floating charge gives way to a fixed charge, or vice versa*". Instead, he considered that the case law on fixed and floating charges seemed to support "*a nuanced approach to the question of whether a charge is fixed or floating, which requires a number of factors to be taken into account*".

*Re Avanti Communications* undeniably provides for more latitude. However, whenever there is a "*spectrum of possibilities*" there will also remain uncertainty.

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