Jon Moulton's Diary

Do we really need the concept of floating charges?

Veteran financier Jon Moulton has been involved in buyouts, turnarounds and venture capital since 1979 with firms such as CVC, Permira, Apax, Alchemy and, most recently, Better Capital, where he has been the chair since 2009

'Since then [the establishment of the floating charge], there has been many a twist and turn in the courts and in practice and some statute'

Security over assets is a basis for a great deal of finance for businesses. The potential to recover some, even all, of a lender's loans in the event of bankruptcy cuts down the cost of borrowing for companies. This security, of course, means that unsecured creditors may get little or nothing back from a business failure as the secured lenders swipe the remaining value for themselves. This bill is generally felt to be more than offset by the benefits of the cheaper and more abundant debt that secured creditors provide.

A floating charge is a security interest over a fund of changing assets of a company. Unlike a fixed charge, which is created over definite ("fixed") property, a floating charge is created over property of an ambulatory and varying nature, such as receivables and stock.

The history of the floating charge is one of judge-created case law based in equity and precedent.

These cases go back to at least 1870, in a memorably named case from the glory days of empire, "Re Panama, New Zealand, and Australian Royal Mail Co," when The Court of Appeal held that the effect of the documents was that the secured creditor could not interfere with the running of the business and its ability to deal with its own assets until the failure of the company, but the occurrence of failure entitled the secured creditor to realise its security over the assets and to assert its charge in priority to the general body of creditors.

This was the floating charge — established without any legislation at all.

Twist and turn

Since then, there has been many a twist and turn in the courts and in practice and some statute.

At its simplest a clearing bank would always take a full "fixed and floating charge over all the assets" expecting to collect from the sale of property and plant and machinery under a fixed charge and to collect under the floating charge from the disposal of stock and the realisation of debtors. This simple picture was spoilt by the liquidator's fees and intermittent, largely political, interventions into the order of priority which for a

Such a woolly concept as floating charges — which can include assets from inventories to vehicles — can have a serious impact on investors

long time meant that unpaid wages and taxes ("Crown Preference") was paid before a lender's charge on floating charges and the unsecured creditors got the last pickings — if there were any.

In 2002 the government abandoned this "Crown Preference" as part of the Enterprise Act. In 2020 for no very compelling reason, HMG reinstated it thus giving taxes a preference over other unsecured creditors in respect of floating charge assets from 2020.

In the meantime, the troublesome definition of a floating charge reached the House of Lords in 2005 where seven peers (of varied opinions) were called on (in Gilbert and Sullivan style) to opine on a £16k dispute on a structure then commonly used to put debtors into the fixed charge. They found against it and put the proceeds from debtors into a floating charge. This was the Spectrum case.

A couple of the lords pointed out how easy it was to avoid this judgment by using invoice discounting and similar structures – a minority recommended killing off the whole concept of a floating charge. And avoidance is easy – for example you can convert the proceeds of a sale of inventory by putting all the inventory into an otherwise empty SPV and if failure occurs then you have a fixed charge on the SPV shares and get the proceeds from inventory sales without sharing with HMRC, as the inventory is not subject to a charge.

There has been one more recent well publicised 2023 case, Avanti (a satellite operator — giving a whole new meaning to fixed plant), which also gets into the issues of how much control is needed for a lender to achieve the desired fixed charge. But it helps little.

Clearer definition needed

The reality is that there are today varied opinions as whether or not fixed assets such as plant can be, or are, subject to a fixed charge — which seems remarkable after 150 years of practice. Some lawyers even doubt that a full prohibition of dealing with plant is adequate to generate a fixed charge.

Why we still have such ill-defined things as floating and fixed charges having significant economic effects is far from clear. Uncertainty costs.

Given the ready filing of charges at Companies House it would be easy for a borrower to simply allow assets to be shown as charged as appropriate. You could file for the charging of individual assets, or all assets, and counterparties that trade with the business would be on notice as to the risks they might be incurring in trading with the company.

Given a bit of anti-abuse regulation this should work. The clearest losers would be lawyers currently collecting well from giving uncertain advice. Crown preference and any ringfenced fund for unsecured creditors could be easily accommodated.

Currently, the UK's most visible distressed debt company, with a very complex structure, is Thames Water. Floating charges?

Getty Images