

SECURED TRANSACTIONS REFORM: FIXED AND FLOATING CHARGES ON INSOLVENCY

Outcome of the meeting on 15 July 2014

- 1 The purpose of this note is to summarise the main issues discussed at the meeting held at Norton Rose Fulbright on 15 July 2014 to discuss fixed and floating charges on insolvency.

Summary

- 2 There were three key conclusions:
 - There is a problem with the existing law. It needs to be reformed.
 - The first thing to do is to decide whether (and, if so, to what extent) there needs to be a levy on secured creditors to fund administrations.
 - If such a levy is required, it needs to be decided how to impose it in a way which is both fair and certain.

The problem

- 3 There was a general consensus that there is a problem with the current law. It imposes a levy on floating chargees, but not on fixed chargees. Because of the difficulty, in many cases, of deciding whether a charge is actually fixed or floating, this creates uncertainty and complication.
- 4 The problem is particularly apparent where the security is taken over a particular asset in circumstances where the chargor is able to deal with the asset in certain ways before enforcement. This is not security over a fluctuating body of assets (which is the traditional province of the floating charge), but it is nevertheless susceptible to recharacterisation as a floating charge.

Funding administration

- 5 The levy on floating chargees is currently used to pay preferential creditors, a certain percentage of unsecured liabilities, the expenses of administrations and certain expenses of liquidations. In practice, what worries secured creditors most is the expenses of administration because they are often very high and there is no limit to their priority over floating charges.
- 6 The starting point, in considering how to tackle the problem, is therefore how administrations should be funded. The critical questions are:
 - Should an administrator (or, for that matter, a liquidator) be able to use charged assets without the consent of the chargee?
 - If so, for what purposes and subject to what controls?

- 7 There are two policy considerations here:
- The first is the need to promote the availability of secured credit for businesses. This requires the secured creditor to be certain about the extent to which it is entitled to the proceeds of the secured assets.
 - The second is the desire to preserve those businesses in administration which are worth saving. This requires administrators to have sufficient funds to enable them to sell the business as a going concern if it is practicable and sensible to do so.
- 8 These two policy considerations need to be balanced, and a view taken as to the extent to which the latter needs to impinge upon the former.
- 9 It would also be sensible to look again at the way in which preferential creditors should be protected, and the utility of the prescribed part.

The solution

- 10 The solution is dependent on the outcome of the discussion about funding. If it is decided that, at least to some extent, administration expenses must be paid out of charged assets, it then needs to be decided how this should be done. We discussed three options, all of which have their supporters.
- 11 Option 1 would involve a clarification of the existing law. It might be possible to give more guidance on the nature and extent of the control which is required by a fixed chargee. There are real doubts about the practicality of drafting anything which would give real certainty, but it might be used as an interim measure.
- 12 Many PPSA jurisdictions provide that a creditor's control over the charged assets is not affected by the debtor's ability to deal with them before enforcement. That would significantly shift the balance in favour of fixed charges, but would reduce the amount of assets available to fund an administration.
- 13 Option 2 would require the levy to be paid out of some types of charged assets, but not others. There was some support for the proposition that a person who has funded the acquisition of a particular asset should not be subject to the levy but, equally, it is hard to see why the funding of working capital should be regarded as being less valuable than the funding of the acquisition of a particular asset. Any attempt to draw lines of this kind is likely to be divisive.
- 14 Option 3 would impose the levy on a small percentage of all charged assets up to a cap. This is the approach taken at present to the prescribed part, and its advantage is that it would be fair as between all secured creditors and certain as to the maximum amount of the levy. An advantage of this approach is that it follows neatly on from the funding question. If it is necessary to fund the preservation of businesses out of charged assets, then perhaps that is the responsibility of all secured creditors, not just some.
- 15 Although there was quite a lot of support for this approach, there was also a strong body of opinion that a creditor which has funded a particular asset should not be forced to fund the general expenses of an insolvency proceeding. There was also a recognition of the difficulty of getting the percentage and the limit right, and of the fact that what is appropriate in one market may be inappropriate in another.

Conclusion

- 16 The first task is to consider the funding of administrations and, in particular, the extent to which it is necessary to do so out of charged assets. Everything else follows from that.
- 17 It was recognised that, when doing this, it would be useful to find out how insolvencies are funded in practice in other jurisdictions, and the extent to which charged assets can be used for that purpose.

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