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<td>Author(s)</td>
<td>Young, J</td>
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<td>Citation</td>
<td>Hong Kong Law Journal, 2004, v. 34 n. 2, p. 227-244</td>
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<td>Issued Date</td>
<td>2004</td>
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<td>URL</td>
<td><a href="http://hdl.handle.net/10722/87719">http://hdl.handle.net/10722/87719</a></td>
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CHARGE OVER BOOK DEBTS –
THE QUESTION OF CONTROL

Jessica Young*

In Agnew v Commissioner of Inland Revenue,' the Privy Council decided that for a fixed charge to be created over a company’s present and future book debts, the chargee must exercise control over both the uncollected book debts and their realised proceeds. Agnew has thus cast doubt upon the correctness of Siebe Gorman v Barclays Bank Limited, where the debenture in question did not specifically restrict the chargor’s freedom to draw on the proceeds after they were paid into a designated account with the chargee. Recently, a Siebe Gorman-type debenture came under judicial scrutiny in National Westminster Bank plc v Spectrum Plus Limited. The English High Court held that the control conferred by a Siebe Gorman-type debenture was deficient, whereas the English Court of Appeal took a completely different view. The issue of control concerning charges over book debts is therefore still unsettled. This article examines the control requirement in the light of recent cases.

Introduction

In Agnew v Commissioner of Inland Revenue,1 the Privy Council reaffirmed the principle that the characteristic which distinguishes a fixed charge from a floating charge is the control exercised by the chargee over the charged assets, and that for a fixed charge to be effectively created over a company’s present and future book debts, such control must cover both the uncollected book debts and the realised proceeds of the debts. In the light of the Privy Council’s emphasis on control over the proceeds, doubt has been cast upon the correctness of Slade J’s decision in Siebe Gorman v Barclays Bank Limited,2 where the debenture in question did not specifically restrict the chargor’s freedom to draw on the proceeds after they were paid into a designated account with the chargee.

More recently, a Siebe Gorman-type debenture came to be considered by the courts in National Westminster Bank plc v Spectrum Plus Limited. At first instance,3 Sir Andrew Morritt VC declined to follow Siebe Gorman and held that the debenture in question was effective only in creating a floating charge.

* Assistant Professor, Faculty of Law, University of Hong Kong.
1 [2001] 2 AC 710.
2 [1979] 2 Lloyd’s Rep 142.
3 [2004] 1 All ER 981.
The Vice Chancellor's decision was reversed on appeal. The English Court of Appeal unanimously held that the debenture in question gave the chargee the necessary control (albeit in a limited way) for a fixed charge to be created. The case is presently on appeal to the House of Lords. It would therefore appear that the question of control in charges over book debts is still one which is taxing the brains of lawyers in the many jurisdictions, including Hong Kong, whose law on security interests over personal properties mirrors the English common law. It is the purpose of this article to examine the question of control in the light of recent cases.

Fixed Charge Distinguished From Floating Charge – the Control Requirement

In an oft-quoted passage in Re Yorkshire Woolcombers Association Ltd, Romer LJ identified the three characteristics of a typical floating charge as follows: (1) the charge is over a class of assets, present and future; (2) the class of charged assets is one which in the chargor's ordinary course of business would change from time to time; and (3) the chargor is free to carry on its business in the ordinary way until the chargee takes steps to intervene. The third characteristic described by Romer LJ means that the chargor remains free to deal with those assets covered by the floating charge, and may deal with them in a way which is inconsistent with the chargee's security interest. In short, control over the charged assets remains with the chargor rather than the chargee. Subsequent cases have recognised that it was the "control" element which distinguishes a floating charge from a fixed charge.

Leading Cases on Charges Over Book Debts

Position Before Siebe Gorman

Book debts are debts which arise out of the ordinary course of business and are of the type normally entered in well-kept books of that business. For many small and medium-size trading firms in Hong Kong, book debts form an important, if not the only, asset which may be offered to banks as security for

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5 [1903] 2 Ch 284, 295.
6 For judicial pronouncements on what "book debts" are, see Shipley v Marshall (1863) 14 CB (NS) 566; Dawson v Isle [1906] 1 Ch 633; and Independent Automatic Sales Ltd v Knowles and Foster [1962] 3 All ER 27. In Re Brightlife [1986] BCLC 418, 421, Hoffmann J. held that a credit balance in a bank account is not a book debt.
loan facilities. For a business which is actively trading, book debts are continually incurred and repaid. It is therefore natural for banks to want their charge to cover not only the firm’s existing book debts, but also its future book debts.

Historically, the common law did not recognise a charge by a person of future property. However, since Tailby v Official Receiver, it has been recognised that, in equity, a person can validly charge all his present and future book debts, and that, upon the execution of the charge document, a security interest arises which will attach itself to the after-acquired debts immediately upon their coming into being.

Siebe Gorman v Barclays Bank Ltd
In Siebe Gorman, Slade J held that it is possible to create a fixed charge over a company’s present and future book debts. The crucial question to ask is not whether the charge is over an ambulatory or shifting body of assets, but rather, whether the charge gives the chargee the requisite control over the charged assets.

In Siebe Gorman, the chargor company executed a debenture in favour of Barclays Bank Limited which purported to create a fixed charge over all of the chargor’s present and future book and other debts. The debenture prohibited the chargor from assigning or charging its debts to any third parties, but permitted the chargor to collect the debts for the benefit of the chargee. Upon collection, the chargor was required by the debenture to pay all proceeds realised from such debts into a designated account (which was its running business account) with the chargee. The debenture, however, contained no express restriction against the chargor drawing on the account.

On the facts, Slade J found that there existed the requisite control over the charged assets for the charge to be a fixed charge. Whilst the book debts remained uncollected, the chargor was restricted by the negative pledge clause in the debenture from assigning or charging them. Upon collection, the chargor was obliged to pay the proceeds into the account designated by the chargee and maintained with it. Despite the absence of any prohibition against the chargor drawing on the designated account, his Lordship found an “implied restriction” against withdrawal. According to his Lordship, the chargee could, if it so chose, “assert its lien under the charge on the proceeds of the book debts, even at a time when the particular account into which they were paid was temporarily in credit”. Slade J therefore held that the charge over book debts created by the debenture was a fixed charge. The learned judge went

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8 See n 2 above, p 159.
further to say that, if the chargor had the unrestricted right to draw from the account, then he would have been inclined to hold the charge to be merely a floating charge.⁹ Therefore, to Slade J, a restriction against the chargor drawing on the designated account forms an essential part of the control required for a charge over book debts to be fixed. On the facts of Siebe Gorman, his Lordship was satisfied that there was an “implied restriction” and hence the requisite control by the chargee over the proceeds.

*Re Keenan Bros Ltd*¹⁰

The Irish Supreme Court in *Re Keenan Bros* confirmed the “control” test as the determining factor in distinguishing a fixed charge over book debts from a mere floating charge. The debenture in this case was more stringent than the Siebe Gorman-type debenture in its control over the collected proceeds. Not only did it require the chargor to pay all such proceeds into an account designated by the chargee, it also restricted the chargor from drawing on those proceeds after their payment into the designated account. On these facts, the Irish Supreme Court was satisfied that the chargee had sufficient control over the debts charged and upheld this charge as a fixed charge. This decision was cited with approval by the Privy Council in *Agnew.*¹¹

*Re Brightlife Ltd*¹²

The debenture in *Re Brightlife* restricted the chargor against selling, factoring or discounting the debts. However, unlike the debentures in Siebe Gorman and *Re Keenan Bros,* this debenture allowed the chargor to collect the debts for its own benefit and pay the proceeds into an account maintained by it with another bank where they remained at the free disposal of the chargor. Hoffmann J (as he then was) had no hesitation in holding that the debenture in *Re Brightlife* merely created a floating charge over the book debts, notwithstanding the restriction against alienation. By permitting the chargor to collect the debts for its own use and benefit, the debenture in *Re Brightlife* failed the control test required for creating a fixed charge over book debts.

*Re New Bullas Trading Ltd*¹³

Cases like Siebe Gorman, *Re Keenan Bros* and *Re Brightlife* have established that, to effectively create a fixed charge over book debts, the charge in question must satisfy the control requirement described by Romer LJ. The chargee must restrict the chargor’s freedom in alienating the uncollected book debts.

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⁹ Ibid., p 158.
¹¹ See n 1 above, p 722.
¹² See n 6 above.
as well as in the use of the realised proceeds. This necessarily implies that, in ascertaining the nature of a charge over book debts, the court would consider the parties' respective rights and obligations in respect of not only the uncollected debts, but also their realised proceeds.

The draftsman of the debenture in Re New Bullas, however, segregated the book debts from their proceeds and treated them as two distinct and independent assets. The debenture purported to create a fixed charge over the uncollected debts without giving the chargee control over the realised proceeds, which were made subject to a floating charge.

In this case, the charge in question was granted to 3i Plc, which was the second chargee of the book debts concerned. A first charge had already been granted in favour of Lloyds Bank Plc. 3i's debenture purported to create a fixed charge over the chargor's uncollected book debts. The debenture prohibited the chargor from alienating the debts, but permitted the chargor to collect the debts and to pay the proceeds into an account designated by 3i. Bearing in mind that a first charge already existed in favour of Lloyds, 3i designated the account with Lloyd's as the account for the receipt of the proceeds for this purpose. 3i was empowered by the debenture to give direction to the chargor on the operation of the designated account, but if no such direction was given, then the proceeds would be released from the fixed charge and become subject instead to a floating charge. 3i never gave any direction as regards the operation of the account with Lloyds.

This, however, did not prevent the English Court of Appeal from finding 3i's charge over the debts to be a fixed charge. Nourse LJ upheld the freedom of the contracting parties to create a fixed charge over the uncollected book debts and a floating charge over their realised proceeds, thereby implying that, for a fixed charge to be created over book debts, the chargee need not exercise control over their realised proceeds.

Agniew v Commissioner of Inland Revenue
This case involved an appeal to the Privy Council from New Zealand. The debenture purported to create Re New Bullas-type split charges over book debts and their proceeds respectively, and the facts were identical to those of Re New Bullas in all material respects.

In Agnew, the Privy Council adopted a two-stage enquiry. First, their Lordships construed the charge document with a view to ascertaining the nature of the respective rights and obligations which the parties intend to grant each other. Then their Lordships categorised those respective rights and obligations as a matter of law. In the categorisation stage, a critical factor was the control exercised by the chargee over the charged assets. Lord Millett, who delivered the advice of the Privy Council, emphasised that, in law, for a fixed charge to subsist over book debts, the chargee must
have control over both the uncollected debts and the proceeds realised from
the collection of the debts.

Having gone through the two-stage enquiry, Lord Millett concluded that
the charge created by the debenture in Agnew was a mere floating charge.
Whilst acknowledging that it is conceptually possible to separate a debt from
its proceeds, his Lordship regarded any attempt to separate the two when
taking security over the debts “makes no commercial sense”, and expressly
disapproved Re New Bullas. In his Lordship’s view, by permitting the chargor
to collect and get in the debts and turn them into proceeds which the chargor
remained free to use for its own benefit, the debenture in Agnew enabled the
chargor to extinguish the charged assets and remove them from the charge
without the chargee’s consent and without having to account to the chargee
for the proceeds. Such an arrangement concerning the proceeds thus falls
short of the requisite control over the debts, and the security created is there-
fore inconsistent with a fixed charge. For an effective fixed charge to be created
over present and future book debts, the chargee must control the uncollected
debts (by including in the debenture an appropriate restriction against
alienation), the collection process (by requiring the chargor to collect the
debts as the chargee’s agent rather than for the chargor’s own use and benefit),
as well as the collected proceeds (by setting up a “blocked account” into which
the chargor must pay all realised proceeds upon their collection). Lord Millett
added that, for a fixed charge to be effectively created, it would not be suffi-
cient for the debenture to merely provide for a “blocked account”; the blocked
account must also in fact be operated as such.

Though his Lordship did not specifically say that the chargor must be
restricted from drawing from the designated account, Lord Millett clearly
envisaged that the proceeds must be paid into a “blocked account”. The ex-
pression “blocked account” would suggest that the chargor should be prohibited
from drawing from the account except with the chargee’s consent, a feature
which was absent in Siebe Gorman. Although the Privy Council did not spe-
cifically disapprove of it, Lord Millett’s speech in Agnew has raised queries as
to whether Siebe Gorman was correctly decided on its facts. In particular,
Lord Millett expressly approved of the New Zealand High Court’s decision in
Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd where
Tompkins J found a charge to be a mere floating charge on facts almost indis-
tinguishable from those of Siebe Gorman. His Lordship also drew a distinction
between Siebe Gorman and Re Keenan Bros. Referring to the restriction on

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14 See n 1 above, p 729.
15 Ibid., p 730.
16 [1994] 3 NZLR 300.
17 See n 1 above, p 726.
the use of proceeds, his Lordship said the restriction was “thought to obtain” in *Siebe Gorman* and “did obtain” in *Re Keenan Bros.*

**National Westminster Bank Plc v Spectrum Plus Ltd**

(1) The English High Court's view on post-collection control

The *Siebe Gorman*-type debenture has been rather widely used in the banking circles. Since Agnew, there has been considerable concern among bankers over the effectiveness of their securities. An opportunity arose earlier this year for the courts to scrutinize a *Siebe Gorman*-type debenture. In *Spectrum Plus*, Sir Andrew Morritt VC was asked to examine a standard form debenture of the National Westminster Bank Plc which contained provisions substantially the same as those considered by Slade J in *Siebe Gorman* as regards the charge over book debts.

Largely following Lord Millett's approach in *Agnew*, Morritt VC adopted a three-stage approach in analysing whether a charge over book debts was fixed or floating. First, the Vice Chancellor construed the charge document to ascertain the nature of the rights and obligations which the parties intended to grant to each other in respect of the book debts. The debenture in *Spectrum Plus* prohibited the chargor from alienating the book debts without the chargee's consent, and required the chargor to pay the proceeds of all debts collected into its current account maintained with the chargee. There was, however, no restriction against the chargor drawing cheques against such account. In other words, after having paid them into an account with the chargee, the chargor was free to access and use the proceeds in the ordinary course of its business.

Secondly, the Vice Chancellor determined from those rights and obligations whether it was the intention of the parties that the chargor be at liberty to deal with the book debts and withdraw them from the security. The Vice Chancellor found that such was the parties' intention. His Lordship found that the parties intended that proceeds of the book debts be made available for use by the chargor in the ordinary course of its business. The chargor was allowed to operate its current account in the normal way and thereby gain easy access to the proceeds which it was free to use.

Lastly, the Vice Chancellor considered whether the parties' intention was consistent with the nature of the charge which the charge document purported to create, namely, a fixed charge over the chargor's present and future book debts. His Lordship had no hesitation in answering this question in the negative. Though reluctant to deviate from another High Court decision, the Vice Chancellor held that, on its facts, *Siebe Gorman* was wrongly
decided and the charge in that case was only a floating charge. After analysing Lord Millett's speech in *Agnew* and, in particular, those areas where *Siebe Gorman* was discussed, the Vice Chancellor concluded that any charge which envisages the free use of the debt proceeds by the chargor through the ordinary operation of its bank account, as the debenture did in *Siebe Gorman*, must necessarily be a floating charge.19

The Vice Chancellor's decision would seem to be consistent with, and almost inevitable in the light of, Lord Millett's speech in *Agnew*. It sought to clarify the issue of post-collection control by valiantly declaring *Siebe Gorman* to be wrong on its facts and that, for a fixed charge to be created over book debts, the chargor must also be prohibited from drawing on the designated account, viz. the parties must implement a "blocked account" as envisaged by *Agnew*.

(2) The English Court of Appeal's view on post-collection control
Morritt VC's decision was unanimously reversed on appeal. The Court of Appeal's judgment was delivered by Lord Phillips MR. After analysing the Vice Chancellor's judgment and the exact nature and extent of the restriction imposed by the debenture, the Master of the Rolls concluded that Slade J could properly have held the charge in *Siebe Gorman* to be a fixed charge.

Lord Phillips' conclusion was essentially based on two grounds. First, the account remained overdrawn at all material times (except for a very short period), as was intended by the parties. All proceeds paid in were immediately applied by the chargee to reduce the chargor's overdraft. Sufficient restriction therefore existed over the proceeds even without a restriction on drawing, because the chargor was never free to use them for any other purposes. To his Lordship, it was "wholly artificial" to ask whether sufficient control existed over the account if it should go into credit.20 Secondly, irrespective of the state of the account, the "limited restriction" found by Slade J should not be critical in determining whether sufficient control exists for a fixed charge to be validly created.21 Once they are paid into the account, title to the proceeds passes absolutely to the chargee. The "proceeds" cease to exist in law, and are replaced by a chose in action, namely, an obligation by the chargee bank to repay an equivalent sum to the chargor when the chargor seeks to withdraw from the

19 See n 3 above, p 996.
20 See n 4 above, para 95.
21 See n 4 above, at para 94: Lord Phillips remarked that whether the debenture imposed the "limited restraint" against withdrawal as found in *Siebe Gorman* should not be a critical factor in categorising a charge. To his Lordship, it was "at least arguable that a debenture which prohibits a chargor from disposing of book debts before they are collected and requires him to pay them, beneficially, to the chargee as and when they are collected properly falls within the definition of a fixed charge, regardless of the extent of his contractual right to draw out sums equivalent to the amounts paid in".
account.\textsuperscript{22} Whether the chargor has the right to withdraw from the account depends on the terms of the banker-customer contract, which, in the opinion of the Master of the Rolls, is a matter entirely irrelevant to the categorisation of a charge.\textsuperscript{23} Keen as he was to uphold Siebe Gorman, his Lordship further added that even if he were to hold that Siebe Gorman was wrongly decided, he would have been inclined to hold that a Siebe Gorman-type debenture creates a fixed charge over book debts by customary usage.

Lord Phillip's first ground pre-supposes that some form of post-collection control of the proceeds is required to create a fixed charge over book debts. His Lordship observed that, in Siebe Gorman, sufficient control existed over the proceeds by requiring their immediate payment into the chargor's current account with the chargee where there was an outstanding overdraft. His Lordship was correct in concluding that, in such circumstances, the chargor could never have used the proceeds for purposes other than reducing its overdraft. Yet, the main weakness of his Lordship's argument lies in his assumption that the account would never go into credit. Unexpected though it might be, such a situation could and often does happen. Even the account in Siebe Gorman was out of the red for a brief spell. In such a case, whether the chargee had the right to restrict withdrawal would be relevant to ascertaining whether there existed sufficient post-collection control over the proceeds in the manner envisaged by Agnew.

Lord Phillips did not specifically answer the question whether the chargee had the right to restrict withdrawal if the account had gone into credit. However, his Lordship was of the view that the chargor remained free to operate the account unless and until the chargee exerted its limited "implied restriction" which Slade J found. To the Master of the Rolls, whether there existed any restriction against withdrawal is irrelevant to categorising the charge over book debts. For a charge over book debts to be fixed, the chargee must be given control over the collection and use of the proceeds. However, such control need only exist so long as there are proceeds. Once the proceeds disappear upon their payment into the designated account, the control requirement ends there as well. How the designated account is to be operated is a separate issue which, to his Lordship, is irrelevant to the nature of the charge over book debts. His Lordship's approach in effect dispenses with a "blocked account" completely and thus can hardly square with Agnew. In the light of the House of Lords' previous approval\textsuperscript{24} of Agnew, it is believed that a dispensation with the "blocked account" requirement would be unlikely.

\textsuperscript{22} Foley v Hill (1848) 2 HL Cas 28.
\textsuperscript{23} See n 4 above, para 94. This analysis has the support of some commentators, see Yeowart, "Comment: Where Does Brumark Leave Fixed Charges?" [2001] IFLR 15 and S. Rajani, "Fixed Charges over Company's Book Debts After Brumark" (2001) 17 IL & P 125.
\textsuperscript{24} Agnew was cited with approval by Lord Hoffmann who delivered the leading speech of the House of Lords in Re Cosslett (Contractors) [2002] 1 AC 336, 352.
The Controversy Over Post-collection Control in Charges Over Book Debts

Reluctance to Undermine Siebe Gorman's Authority
It is apparent from Lord Phillips' reference to customary usage that the English Court of Appeal was at great pains to salvage Siebe Gorman and try to fit it within the "control" framework mandated by Agnew. The Court of Appeal's reluctance to upset Siebe Gorman's authority is perfectly understandable. As Lord Phillips pointed out in Spectrum Plus, the Siebe Gorman-type debenture has been widely used by the banking circles since it was judicially endorsed 25 years ago. Banks, borrowers and other related parties have organised their affairs on the understanding that the charge created by this type of debenture is a fixed charge. Certainty is extremely important in commercial transactions. To thwart the parties' intention by holding that such a debenture is only effective in creating a floating charge will undoubtedly bring about undesirable consequences in the banking circles.

Many practitioners have already questioned the practical wisdom of requiring post-collection control over the proceeds in the form of a restriction against drawing on the designated account.\(^{25}\) Not only does a "blocked account" requirement impose undue administrative burden on bank chargees who must constantly monitor the operation of the account, it will unnecessarily increase administrative costs which may well increase borrowing costs indirectly. Worse still, a "blocked account" will inevitably deny a chargor access to one of its main sources of cash flow. This is particularly bad news to the many small and medium-sized trading enterprises in Hong Kong which may have little to offer banks by way of security other than their book debts. By creating a fixed charge over book debts and thus restricting the enterprise's access to the designated account, a bank is virtually forcing the enterprise to bring its business operations to a grinding halt. In most cases, this will be quite contrary to the parties' intentions – after all, loan facilities are usually extended with a view to financing the enterprise's continued business operations.

Besides, a "blocked account" requirement will virtually render it impossible for a second chargee or a non-bank chargee to take a fixed charge over book debts. The facts of Re New Bullas will illustrate this point. 3i, the chargee in Re New Bullas, was a second chargee. It had already done everything it possibly could to control the collected proceeds: 3i designated the account with Lloyds Bank Plc (the first chargee) as the account into which all such proceeds must be paid, and had the right under its debenture to issue

\(^{25}\) See Yeowart (n 23 above).
directions to the chargor on the operation of the designated account. Until the discharge of Lloyds' prior charge, it would have been pointless for 3i to issue any direction to the chargor on the operation of that account. Yet, adopting the “blocked account” requirement in Agnew, the absence of control on the part of 3i over the designated account would necessarily mean that 3i’s charge can only be a floating charge. Similarly, the English Court of Appeal in Spectrum Plus regarded it to be “of critical importance” that the designated account was maintained with the chargee, a condition quite impossible to fulfil in cases where the chargee is a second chargee or a non-bank chargee. The impracticability in restricting withdrawal from the designated account would thus deprive a second or non-bank chargee of the possibility of ever taking a fixed charge over book debts as security.

As Lord Phillips pointed out, a bank balance is technically a distinct asset from the deposits which give rise to it. In law, they constitute two different assets, each of which is available for a chargor to offer to its banks and other creditors as security. The economic value of book debts can be realised by disposal before their maturity or by collection upon their maturity. As for a bank balance, most creditors would regard it as almost as good a security as cash. Each of these two assets has its own economic value and many banks would regard them as two distinct sources of fund for the repayment of their outstanding obligations. If not for the “blocked account” requirement, a chargor would have been able to charge these two assets separately to different creditors as security for different obligations. After Agnew, this is no longer possible where one creditor is taking a fixed charge over the book debts. Not only does Agnew require control to be exerted over the proceeds upon their collection, it must also be exerted over the “asset” which such proceeds are used to acquire, namely, the chose in action in respect of the account balance. Without specifically requiring the chargee of the book debts to also take a fixed charge over the designated account, Agnew requires the chargee to impose restrictions against the chargor drawing on the account, thereby denying the chargor access to the monies standing to its credit. In practice, such an arrangement would make it impossible for the bank account to be made available as security to any other creditors of the chargor.

Much of the criticism against the “blocked account” requirement stems from genuine concerns of the banking circles and the practical difficulties faced by them in taking security over book debts. However, having regard to the subject matter of the charge and how control can be exercised effectively in practice by the chargee over the charged assets, it would appear that it is the correct approach to extend post-collection control beyond requiring payment of all proceeds into a designated account, by also requiring that the chargor be restricted from drawing on the account.
How Control may be Exercised Over Book Debts

A characteristic of a fixed charge is the control exercised by the chargee over the charged assets which are unconditionally appropriated to meet the secured obligation. The requirement of control over the debt proceeds in a charge over book debts emanates from this characteristic. What complicates matters is the peculiar nature of book debts. If the fixed charge is created over a chattel, then whether the chargee has control over the charged chattel is a relatively straightforward matter. A debt, however, is a chose in action. It is incapable of physical possession and cannot be enjoyed in specie. Its entire economic value is in its realisation, either by disposal or collection. The latter is by far the more common method of realisation, but it is also a process which, by its very nature, must necessarily extinguish the debt itself.

Control over the charged debt must involve restriction against the chargor alienating the debt by factoring, assigning or other forms of disposal. However, that alone is not sufficient. If the chargor is left free to collect the debt (thereby extinguishing the subject matter of the charge) and then use the proceeds for its own use and benefit, then the whole purpose of the charge would have been defeated. The main intention behind the creation of a fixed charge is to enable the chargee to have recourse to the charged asset in the event of default, so that the chargee can realise the charged asset and appropriate the proceeds towards repayment of the secured obligation. A charge which restricts the chargor from alienating the debts without restricting its freedom to collect and use the proceeds is thus of little use or value to the chargee (if at all). As Professor Goode aptly points out, the only way a fixed chargee can assert its security interest in the charged debts is through the proceeds.26 Besides, as Lord Millett observed in Agnew, a charge which permits the chargor to freely deal with the charged assets and withdraw them from the charge is more closely akin to a floating charge than a fixed charge. In the case of charges over book debts, if no control is imposed on the collection and use of the realised proceeds, then the chargor may, by the act of collection, extinguish the debts and thus withdraw them from the charge, without having to account to the chargee for the proceeds. This would be quite inconsistent with the nature of a fixed charge.

The issue is further complicated by the payment of the collected proceeds into a bank account. Nowadays, with the widespread use of highly accessible banking services, it is unrealistic to expect a person to hold large amounts of cash instead of deposit them into a bank account. It is therefore both natural and logical for a debenture to contemplate and require the chargor to deposit the proceeds realised from the collection of its book debts into a bank account.

The law, however, treats the account balance as an asset separate from the deposits which give rise to it, such that the depositor ceases to have any title, legal or equitable, in the deposits upon their payment into the account. Its only claim is as a creditor of the bank under the banker-customer contract. Therefore, in all cases involving a fixed charge over book debts, the proceeds will inevitably lose its “legal character” upon their deposit into the designated account. They will be used either to repay an existing overdraft (as in Siebe Gorman) or, if the designated account is in credit, to acquire a “new asset”, namely, the contractual right of the depositor against the bank to demand repayment of the account balance. The controversy which has arisen since Agnew over the requisite post-collection control, and hence, the important question before the House of Lords in Spectrum Plus, is essentially the question of how much control over the designated account is required for the initial charge over the book debts to be categorised as a fixed charge. In short, how far must the control go?

Should Post-collection Control be Required?

Lord Millett in Agnew categorically stated that any attempt to disregard the treatment of the proceeds whilst taking security over the debts “makes no commercial sense”. His Lordship also remarked that it is a characteristic of a fixed charge over book debts that “the debts are not available to the company as a source of its cash flow”. Harsh though it may seem to the many small and medium-size enterprises who need bank financings, it would appear that his Lordship has duly considered the cash flow issue, but, on principle, still insisted on the “blocked account” requirement regardless. As discussed already, such a requirement is necessitated by the unique nature of book debts and their niceties.

Indeed, Lord Millett’s view on the “indivisibility” of a debt from its proceeds has the support of some academic writers. A strong proponent is Professor Goode who advocates the theory of a “single and continuous security interest” which flows from the debts through to their realised proceeds. In his learned article, Professor Goode stated that his discussion was based on the assumption that, upon payment of the collected proceeds into the designated account, the charge over book debts will be “replaced by a charge on the proceeds”. Here, by “proceeds”, Professor Goode was clearly referring to monies standing to the credit of the designated account. This would suggest that Professor Goode did not find it necessary in the present context to

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27 See n 1 above, p 729.
28 Ibid., p 730.
30 Ibid., p 606.
distinguish between the debt proceeds and the bank balance arising from their payment into the designated account. Moreover, in the latest edition of his learned work, *Legal Problems of Credit and Security*, Professor Goode endorsed and supported the Privy Council's approach in Agnew.

What would have been the legal effect if, as suggested by Lord Phillips MR in *Spectrum Plus*, the law did not require control to extend beyond payment into the designated account? It is submitted that, although Lord Phillips' distinction between an account balance and the deposits giving rise to it is technically correct, it is an overly artificial distinction to make when considering the chargor's freedom or otherwise to use the proceeds. A provision which enables the chargor to play the "round robin" trick by paying the proceeds into its account and immediately drawing a corresponding amount from it is hardly any restriction on the use of the proceeds. The chargor is still able to access them, albeit in an indirect way, in the ordinary course of its business as if no charge were created. This is clearly indicative of a floating charge.

Indeed, if one adopts the distinction drawn by the English Court of Appeal between a bank balance and the deposits which give rise to it, then why is it objectionable for a *Re New Bullas* debenture to release the proceeds from the fixed charge over book debts upon their payment into a designated account and provide for the creation instead of a separate floating charge over the account? Sufficient control would have existed merely by 3i requiring the chargor to pay all realised proceeds into its account with Lloyds. Upon their payment into the Lloyds account, presumably the proceeds would have disappeared and become replaced by the chargor's chose of action against Lloyds. On that analysis, whether 3i gave any direction on the operation of the account with Lloyds would have been completely irrelevant to the question of control over the "proceeds", for the "proceeds" would have disappeared by then. Yet, the Privy Council in Agnew expressly disapproved *Re New Bullas* and criticised it for upholding a fixed charge over book debts when the debenture failed to give 3i control over the operation of the designated account. In this respect, their Lordships in Agnew drew no distinction between the account balance and the deposits which give rise to it. Therefore, since it is a pre-requisite for a fixed charge over book debts for the chargee to have control over the proceeds, such control must cover not only the brief spell between the time of collection and the time the proceeds are paid into the designated account. Control must also extend to the operation of the designated account and the monies standing to its credit. As Smart rightly points out, if the account balance is an entirely separate asset and irrelevant to the question of control over the proceeds, then why was the designation of the

31 See n 26 above.
chargor’s ordinary business account in *Re Brightlife* insufficient to satisfy the requisite control?\(^{32}\)

It is also submitted that the result achieved by a “blocked account” requirement will be consistent with that achieved by creating security over book debts by way of a legal assignment. Basically, a bank may take a fixed security over a debt in either of two ways. First, the debt may be specifically assigned by the creditor to the bank, with the assignment completed by serving notice of the assignment on the debtor. In such a case, the debtor is not released until payment is made to the assignee bank. As assignee of the debt, the bank would be entitled to retain the proceeds and apply them in repayment of the secured obligation upon its maturity or upon default. It is highly unlikely that the bank would release the proceeds to the chargor to be used in the ordinary course of its business. Alternatively, fixed security may be taken by the bank over a debt by way of a fixed charge under which the bank may permit the chargor to collect the proceeds as agent for and on behalf of the bank, whilst all collected proceeds are required to be paid into a designated account with the bank. (In fact, this is what the debenture in *Siebe Gorman* provided.) It is in this context that the question of post-collection control over the account arises. In *Agnew*, Lord Millett expressly opined that both methods are equally effective in creating fixed security over book debts. So if they are merely alternative ways of creating fixed security over the same subject matter, then there seems to be no good justification why the chargor should be permitted to access and use the proceeds after they are paid into a designated account, whereas it would not be entitled to use the proceeds at all if the security is taken by way of a legal assignment. Any inconsistency in approach in this respect would appear to be unsupportable.

**Practical Solutions**

*The “two accounts” Arrangement*

It would seem from the above analysis that, owing to the unique nature of book debts, it is both inevitable and correct in law to insist upon post-collection control in the form of a restriction against drawing from the designated account, if a fixed charge is to be created over book debts. However, it will be unrealistic to impose a “blocked account” requirement without due regard to its practicalities and the possible adverse implications on both the chargor and the chargee. In particular, it will be unrealistic to expect chargors to be agreeable to an arrangement which would completely deny them access to

\(^{32}\) Smart, “The Irrelevance of Banking Law” (to be published).
their main source of cash flow. Therefore the issue of consent is crucial whenever a fixed charge is to be created over book debts, and must be carefully considered when imposing a “blocked account” requirement.

In this connection, one must bear in mind Lord Millett’s remark in Agnew that the “blocked account” must be operated as such in practice. Lord Millett’s speech suggested that consent must be applied for in the case of each individual withdrawal. The Privy Council in Agnew approved the Australian case of Hart v Barnes which held that a collateral agreement by the chargee giving blanket consent to the chargor to withdrawals rendered the charge floating instead of fixed. However, it is practically impossible for consent to be sought for each payment if the account in question is an ordinary business account of the chargor. Hoffman J (as he then was) referred to an arrangement whereby a company must seek the bank’s consent every time it issues a cheque as an “extreme commercial improbability”.

To alleviate the hardship caused by Agnew on chargors of book debts, it has been suggested that, instead of seeking the bank’s consent for each and every payment, there should be put in place instead a “two accounts” arrangement. Under this arrangement, the charge would, if it thinks fit, consent to a monthly transfer from the designated account to another account with the chargee, provided that the amount to be transferred is envisaged by the monthly budget prepared by the chargor and approved in advance by the chargee. The chargor would be entirely free to operate this second account in accordance with its business needs, whilst the chargee retains strict control over the designated account. In this way, the chargee maintains control over the designated account (and hence fulfil the post-collection control requirement) without completely denying the chargor access to its main source of cash flow. In Spectrum Plus, the English Court of Appeal took the uncharacteristic move of adding a post-script to its judgment and judicially endorsing this “two accounts” arrangement as being consistent with a fixed charge over book debts. This arrangement ingeniously provides the much-needed relief to the harshness of post-collection control in the form mandated by Agnew. It is hoped that it will also receive the blessing of the House of Lords.

**Maintenance of a Minimum Balance**

It has been suggested that, where the bank does exercise control over the designated account, the fact that such control is limited to a specified amount

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33 See n 1 above, p 730.
34 Ibid., p 729.
36 See n 6 above, p 209.
is not inconsistent with the nature of a fixed charge. Therefore, for the purpose of satisfying the post-collection control requirement, it should be sufficient for the debenture to require the chargor to maintain at all times a minimum balance in the designated account but otherwise permits the chargor to draw from it.

Conclusion

In Agnew, the Privy Council laid down the requirement that, for a fixed charge to be created over book debts, the debenture must give the chargee post-collection control over the realised proceeds in the form of a “blocked account”. In the light of this criterion, it is difficult to see how a Siebe Gorman-type debenture can effectively create a fixed charge. The English Court of Appeal made a feeble attempt in Spectrum Plus to uphold Siebe Gorman’s authority, but the reasons given by their Lordships in support are unconvincing.

Many of the concerns expressed by the business community over the practicability of a “blocked account” arrangement are genuine and legitimate. However, as discussed in this article, control over the designated account is both necessary and inevitable, owing to the peculiar nature of book debts. It is hoped that the House of Lords decision will settle the controversy over post-collection control once and for all, and efforts can then be concentrated on devising practicable solutions within the “control” framework required by law, such that the inconveniences resultant from the operation of “blocked accounts” may be minimised.

38 See n 26 above, para 4-20, citing ABN Amro Bank NV v Chiyu Banking Corp Ltd [2000] 3 HKC 381.