High Court finds borrower's security confers floating charge, despite intention of parties to create fixed charge and lender's contractual power to exercise control

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The High Court has found that a borrower's debenture granted to a lender in respect of certain internet protocol (**IP**) addresses was a floating charge. The decision was made by the Insolvency and Companies List in the context of an application by a liquidator of the borrower seeking clarification as to whether the debenture had the effect of giving the lender the benefit of a fixed or floating charge: *UKCloud Ltd, In the Matter Of (Re Insolvency Act 1986)* [2024] EWHC 1259 (Ch).

This decision will be of interest to financial institutions considering the structure of their security arrangements or seeking to enforce their security. The characterisation of a charge has significant practical consequences because a fixed charge grants a lender priority over specific assets, whereas a floating charge ranks after certain preferential creditors and liquidation expenses. The judgment is a reminder that, as per *Re Spectrum Plus Ltd* [2005] UKHL 41, the label used in a debenture to describe the nature of the charge created over an asset or class or assets is a guide to the security the parties intended to create, but it is not conclusive. However, the parties may have chosen to describe a charge, if it is properly speaking a floating charge, the court will treat it as such. This is the latest in a recent line of decisions considering the distinction between a fixed and floating charge (see our previous blog post here).

In the present case, the court was tasked with interpreting and characterising the debenture accordingly to the well-established two-stage test in *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28. The court easily determined from the language used in the debenture that there was an intention to create a fixed charge on the IP addresses. However, when considering the nature of the charge as a matter of law, irrespective of the parties' intentions, the court concluded the charge was in fact a floating charge. The decisive factor in the court's decision was the lender's lack of practical control over the IP addresses despite the debenture explicitly providing the lender with the power to exercise control in theory. The court also emphasised the "all or nothing" principle, meaning that all assets falling within a clause must be subject to either a fixed or floating charge, ie a single clause cannot be read so as to create a fixed charge over some of the assets, but a floating charge over the others.

In terms of practice points, the decision illustrates that for a charge to be categorised as a fixed charge, lenders need to be able to exercise control over a secured asset in practice. Lenders should consider the feasibility of being able exercise such control and, if this is unlikely to be possible, it may be prudent to recognise from the outset that the lender will have a floating charge only (and therefore assign a reduced value to the asset in the overall security package). If there are valuable key assets over which control can be exercised, these should be defined clearly (and not included in broad or general language) and should be subject to distinct fixed charge provisions.

We consider the decision in more detail below.

Background

The borrower provided cloud computing services to various organisations, which involved the use of IP addresses. In 2020, the borrower required capital for its business and sought a loan from the lender. As security for the loan, the borrower granted the lender a debenture which purportedly created a fixed charge over certain IP addresses. In 2022, the borrower was wound up and an official receiver was appointed as a liquidator.

As part of its role in collecting and distributing the assets of the insolvent borrower, the liquidator brought an application seeking clarification as to whether the debenture had the effect of giving the lender the benefit of a fixed or floating charge over the IP addresses. The nature of the charge (whether fixed or floating) would significantly affect the distribution of the borrower's assets. A fixed charge would give the lender priority over the specific assets (in this case, the IP addresses), whereas a floating charge would rank after certain preferential creditors and expenses of the liquidation.

The lender argued that it had a fixed charge under the terms of the debenture. The receiver/liquidator adopted a neutral stance, but put forward arguments that the charge was floating. This was not because the liquidator was advocating for this outcome, but to ensure that the court had the benefit of adversarial argument on the issue. The liquidator's duty was to act in the best interests of all creditors, and obtaining clarity on this issue would assist in fulfilling this duty.

Decision

The court found that the charge was a floating charge for the reasons set out below.

<u>Test to determine whether a charge is fixed or floating</u>

The court observed that the label used in a debenture to describe the nature of the charge is a guide to the security the parties intended to create but it is not conclusive. It highlighted that when determining whether a charge is fixed or floating, it requires the application of the two-stage test set out in *Agnew*, as follows:

1. **Constructionof the instrument**: The court must first construe the relevant charge instrument in order to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets.
2. **Categorisation**: The court must then embark on a process of categorisation (or characterisation) of the charge, which is a matter of law. This involves assessing the degree of control the chargee has over the charged assets, irrespective of the parties' intentions.

The court observed that a fixed charge is often easy to identify, especially when it applies to real property, but can be harder to ascertain for other types of assets. However, there is helpful guidance from the court in *Re Spectrum Plus* on the key distinctions between a fixed and floating charge:

- **Fixed**: Under a fixed charge, the assets charged as security are "permanently appropriated to the payment to the sum charged" in such a way as to give the chargee a proprietary interest in the assets. While the charge remains in force, the assets can be released from the charge only with the consent of the chargee.
- **Floating**:By contrast, with a floating charge the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a fund of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the chargor, and not the chargee, to decide how to run its business.

<u>Construction of the instrument</u>

At the first stage of the *Agnew* test, the court determined that the natural and ordinary meaning of the language used in the debenture evidenced an intention to create a fixed charge on the IP addresses.

This was primarily due to the use of terms such as "licences," "consents," and "authorisations" in the debenture. Such terms are often associated with permissions, including permission to use IP addresses. Here, those terms were indicative of an intention to catch the kind of assets and rights that were contemplated as arising in connection with the borrower's business, including those that were less tangible than those to which a debenture is traditionally directed.

The court also emphasised that the "all or nothing" principle applied, meaning that all assets falling within a clause must be subject to either a fixed or floating charge (as *per Re G E Tunbridge Ltd* [1995] 1 BCLC 34). In other words, a single clause cannot be read so as to create a fixed charge over some of the assets, but a floating charge over the others. In the court's view, there was no reason to deviate from this principle.

<u>Categorisation/Characterisation</u>

However, at the second stage of the *Agnew* test, the court determined that the charge was a floating one. The factors that the court took into account in reaching this conclusion included the: (i) nature of the assets; and (b) absence of control.

Nature of assets

The court first considered if the assets were of a nature that made them susceptible to being subject to a fixed charge or a floating charge. In doing so, the court considered whether the IP addresses were part of the borrower's circulating capital or were a fluctuating asset or body of assets (a characteristic commonly associated with the creation of a floating charge as per *Re Spectrum Plus*). However, this exercise was inconclusive.

The court said that the IP addresses did not readily fall under the "circulating" or "fluctuating" description. The borrower had no proprietary interest in the IP addresses, and its capacity to deal with them was limited. It could sub-allocate them, withdraw them in certain circumstances, reassign them and transfer them. However, it could not simply sell or dispose of them and then replenish the gap created as would be the case with stock or some other asset dealt with as part of the "churn" of business conducted by a shop or similar concern.

This meant that one characteristic commonly associated with the creation of a floating charge was absent, but the court underlined that it did not follow that the charge applicable to the IP addresses was fixed.

Absence of control

The court noted the following key factors indicating the absence of control by the lender:

- The terms of the debenture <u>provided</u> for control to be exercised by the lender over the IP addresses, but the court concluded that control had not <u>in fact</u> been exercised. As a stipulation in the charging documents was not adhered to in practice, the result was that the agreement was a "sham" (not in a fraudulent sense) and should be characterised as floating charge (as per *Re Avanti Communications Ltd* [2023] EWHC 940 (Ch)).
- The borrower also had the apparent ability to carry on its business without the consent of the lender. This was a characteristic associated with a floating charge as per *Agnew* and *Re Spectrum Plus*.

Accordingly, for all the reasons above, the court found that the charge over the IP addresses was a floating charge.