

**Liquidation Expenses and Floating Charges
— The Separate Funds Fallacy**

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In the context of the decision by the House of Lords in Buchler v. Talbot, and of the Government's resolve legislatively to overturn that decision, this paper considers the nature of the charge and the mortgage, and asks what effect the creation of such security interests has on the property of the company. It argues that their Lordships appear to have displayed a misunderstanding of the nature of the charge, and might have created significant doctrinal confusion in the process. The paper then provides empirical evidence to suggest that floating charges are not usually taken in order to ensure priority for their holder, and explains their true purpose. It also examines the broader role of liquidation proceedings. It concludes that not to require the floating charge holder to pay for these proceedings allows him to take the benefits of these proceedings at the expense of other creditors.

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INTRODUCTION

What happens to a company's property when it grants a charge over it? How, if at all, is this different from what happens when a company creates a mortgage over the same assets? What is it to own something beneficially, and how is it different from beneficially holding a proprietary right in it? What role is played by floating charges, and is there really no difference between a fixed charge and a floating charge that has crystallised? And what purpose is served by the proceedings which wind up a company? This paper considers all these questions against the background of the recent decision by the House of Lords in *Buchler v Talbot* ("Re Leyland Daf").¹

Their Lordships issued a simple ruling dealing with a simple question, whether the expenses incurred by a liquidator in winding up an insolvent company are payable out of the assets comprised in a crystallised floating charge in priority to the claims of the charge-holder. However, this simple ruling, if taken seriously, has devastating implications for our understanding of ownership and property, of mortgages and charges, and of several important issues in insolvency law.

With great respect, it is submitted that their Lordships' decision is highly questionable at almost every conceivable level. This paper considers the judgment by examining (a) the juridical nature of charges, (b) the functional nature of floating charges and the empirical context in which they operate, and (c) the question whether the chargee derives benefit from a properly conducted winding-up.²

THE FACTS AND DECISION

Leyland Daf Limited ("the Company") is a member of a Dutch group. In 1992 the Company issued debentures which contained a floating charge over the whole or substantially the whole of its undertaking. In the following year the Dutch group collapsed and the charge-holder appointed administrative receivers. On their appointment the floating charge crystallised. The receivers proceeded to realise the assets comprised in the charge and paid the debts (amounting to some £8m) which were preferential in the receivership. They also made interim distributions of some £110m to the charge-holder towards satisfying the secured indebtedness. At the time of the House of Lords hearing, the receivers still held some £72m.

In July 1996, the Company went into creditors' voluntary liquidation. At the time of the House of Lords hearing, liquidation expenses, including the liquidators' remuneration and corporation tax, amounted to over £9.5m before VAT and interest. This figure did not include any provision for future costs of the liquidation, said to be likely to exceed £1m. The liquidators had been able to realise only some £1.4m. There were thus likely to be insufficient unencumbered assets to meet the expenses of the liquidation, and unless the charged assets were available to pay them in priority to the

¹ [2004] UKHL 9; [2004] 2 WLR 582 (unless otherwise indicated, all references to paragraphs are to this judgment).

² Space will not permit discussion of their Lordships' account of the historical development of the relevant statutory provisions; see however the discussion in the Conclusion of this paper.

claims of the charge-holder, there would be nothing with which to pay the greater part of the winding-up costs. In these circumstances the liquidators sought a declaration that the liquidation expenses were payable out of the charged assets in the receivers' hands in priority to the claims of the charge-holder.

The House of Lords refused the liquidators' request. In doing so, their Lordships overturned what had been clear law at least since *In re Barleycorn Enterprises*.³ Their Lordships reason as follows.

First, the issue is not whether liquidation expenses have priority over the charge-holder's claims. For "[t]he real question is whether the expenses of a winding up are payable out of charged assets at all. If they are, there is no doubt that they are payable in priority to the claims of the charge-holder. If they are not, questions of priority do not arise."⁴ In other words, the question is about property, not priority.⁵

Second, assets subject to a floating charge form a distinct fund beneficially owned by the charge-holder to the extent of the secured amount. As a corollary, this charge-holder's fund is separate from assets of the chargor which are not encumbered by any security interests; such free, unencumbered assets are to be realised and distributed among the unsecured creditors in the chargor's liquidation.

Third, each fund bears its own costs of realisation. The expenses of winding-up should only be borne by the chargor's free assets, and — apart from the limited situation where the liquidator incurs expenses in realising assets forming part of the charge-holder's fund — cannot be levied on the charge-holder's fund, since the charge-holder has no interest in the winding-up and derives no benefit from it.

Fourth, it follows that "[t]he significance of the floating charge is, not that it alters priorities for payment out of a single fund, but that it brings a second fund into existence with its own set of priorities."⁶ Thus the fact that preferential claims have priority over the charge-holder's claims in respect of the charge-holder's fund is neither here nor there, in so far as the priority of liquidation expenses is concerned.

Fifth, the above analysis is consistent with legislative history, and the nature and function of floating charges.

THE NATURE OF A CHARGE: THE SEPARATE FUNDS FALLACY

The challenge here is to understand how the creation of a charge bifurcates the chargor company's assets, so that, while the expenses of the winding up rank ahead of preferential claims,⁷ and while preferential claims have priority over the claims of floating charge holders,⁸ it is nevertheless the case that the expenses of the winding up do not rank ahead of the claims of floating charge holders, on the basis that "[a]ssets subject to the charge belong to the charge holder to the extent of the amounts secured

³ [1970] Ch 465 (CA).

⁴ At [41].

⁵ At [87].

⁶ At [81].

⁷ Insolvency Act 1986 (hereafter, "IA"), ss 115 and 175(2)(a).

⁸ IA, s 175(2)(b).

by them”.⁹ It is submitted that this reasoning is wrong. This Section of the paper will initially focus, as a pedagogical tool, on the distinction between a charge and a mortgage to show that, while it is at least possible to construct an argument in favour of their Lordships’ analysis as applied to a mortgage, it is very difficult to understand how the analysis could ever be correct with respect to a charge. It will then be suggested that even with respect to a mortgage, their Lordships’ reasoning is suspect.¹⁰

1. Property and ownership, charges and mortgages

It is submitted that two related confusions seem to be on display in their Lordships’ reasoning, both contributing to errors in their analysis of the nature of a charge. The first and more basic confusion is founded upon ignoring the following proposition: not all proprietary rights amount to beneficial ownership (or beneficial title, sometimes loosely referred to simply as title). Thus stated, the proposition seems startlingly obvious. For our purposes, it is sufficient to say that a right with respect to an asset which is good against the world — and in particular, is binding upon the successor in title of its grantor — is a proprietary right, a right in rem. This is to be contrasted with ownership, which, *for present purposes*, may be understood as the most extensive bundle of proprietary rights with respect to an object at any particular time.¹¹ Consider an easement: X, any owner of Blackacre, has the right to cross over Whiteacre, even against the wishes of Y, any owner of Whiteacre. X has the benefit of a right with respect to Whiteacre, but of course does not own Whiteacre. Yet this is a property right because it binds not just Y1, the owner of Whiteacre when the right was created, but also his successors in title Y2, Y3, and so on. Other instances of the ownership/property distinction may be found in the context of restrictive covenants, profits a prendre, and equitable liens, etc.

The second confusion apparently underlying their Lordships’ judgment is founded upon ignoring the following proposition, roughly parallel to the one mentioned above: not all charges are mortgages. Thus stated, this proposition also seems startlingly obvious — at least to a Property lawyer! A mere charge confers “rights in rem which [are] binding upon third parties and unaffected by the insolvency of the owner of the property charged.”¹² In particular, a “charge amounts to an appropriation of property by the chargor in favour of the chargee as security for the payment of a debt or performance of another obligation... Though the debt or obligation need not as such be paid or performed out of the charged property, ... the chargee has the right of recourse to it in the event of a default by the chargor.”¹³ Put differently, “the creditor is entitled to look to the asset and its proceeds to discharge the indebtedness, in priority to the claims of unsecured creditors... The charge does not transfer ownership to the creditor; it is merely an incumbrance, a weight hanging on the asset which travels with it into the hands of third parties other than a bona fide purchaser of the

⁹ See e.g. at [51] (Lord Millett).

¹⁰ I am very grateful to Alison Clarke for emphasising to me the truth of this point.

¹¹ For an illustration of this understanding, see *Twinsectra v. Yardley* [2002] UKHL 12; [2002] 2 AC 164; at [82], [83] and [87] (Lord Millett).

¹² *Re BCCI (No. 8)* [1998] AC 214, 226 (HL) (Lord Hoffmann).

¹³ See Michael Bridge, *Personal Property Law*, 3rd edn (Oxford, 2002) (hereafter, “Bridge, *Personal Property Law*”), 181-182.

legal title for value and without notice... [A] *mere* charge does not transfer ownership, either at law or in equity..."¹⁴ It follows that the charged assets (i.e. their beneficial ownership or title) remain within the chargor's estate.¹⁵

A mortgage, on the other hand, is "a transfer of ownership of the asset (or of any lesser interest held by the transferor) by way of security upon the express or implied condition that ownership will be re-transferred to the debtor on discharge of his obligation."¹⁶ So the "main difference between a mortgage and a charge is that a mortgage involves a conveyance of property, which is subject to a right of redemption, whereas in the case of a charge there is no conveyance and the chargee is given rights over the property as security for the loan."¹⁷ "[W]hile a mortgagee acquires a right *in re sua* by virtue of the transfer to him[,] the interest of a chargee is a right *in re aliena*."¹⁸ During the currency of the mortgage, therefore, it is at least possible to say that the mortgaged assets no longer form part of the mortgagor's estate. 'All' that the latter has is an equity of redemption, a set of proprietary rights that come into existence as soon as the mortgage is created.¹⁹ By virtue of this equity, the mortgagor might eventually obtain an equitable right to redeem the mortgaged property.²⁰ Put differently, the creation of a mortgage requires the mortgagor to give up title to the mortgaged asset in return for 'mere' proprietary rights in it.²¹

Keeping all this in mind, we may now return to *Re Leyland Daf*, which, let us recall, concerns the effect of a mere floating charge. It seems difficult to avoid the conclusion that their Lordships' insistence that the grant of a charge bifurcates the chargor's assets into two separate funds rests on a basic misunderstanding of the nature of the charge. While the creation of a *mortgage* just might conceivably remove the ownership of the mortgaged assets from the mortgagor's estate into a "separate fund" (more accurately, the mortgagee's estate), this simply is not how a *charge*

¹⁴ Roy Goode, *Legal Problems of Credit and Security*, 3rd edn (London, 2003) (hereafter, "Goode, *Legal Problems*"), 36 (original emphasis; footnote omitted).

¹⁵ Just as the title to Whiteacre remains in Y1's estate despite the grant away of the proprietary right that is the easement. Note that it is sometimes said that X has a beneficial property right with respect to Whiteacre. In this context, this means simply that X holds the proprietary interests constituting the easement in his own right, rather for anyone else. This should not be confusing, as long as a beneficial property right continues to be carefully distinguished from beneficial title or ownership, which, as indicated, is the most extensive bundle of beneficially held property rights with respect to an asset at any time.

¹⁶ Goode, *Legal Problems*, 35.

¹⁷ Law Commission, *Registration of Security Interests* (Consultation Paper No. 164) (TSO, 2002), para 2.14. See also Charles Harpum, *The Law of Real Property*, 6th edn (London, 2000), 1170.

¹⁸ Roy Goode, *Legal Problems of Credit and Security* (3rd ed. Sweet & Maxwell, 2003), p. 36.

¹⁹ *Casborne v. Scarfe* (1783) 1 Atk 603, 605 (HL); *Re Sir Thomas Spencer Wells* [1933] Ch 29, 52 (CA).

²⁰ The equity of redemption, which is the sum total of the rights of the mortgagor during the life of the mortgage and which is vested in the mortgagor immediately upon the creation of the mortgage, "must be carefully distinguished" from the equitable right to redeem (i.e. to *reclaim the title* upon discharge of the secured loan), which arises only once the *contractual* right to redeem has expired; see *Kreglinger v. New Patagonia Meat and Cold Storage* [1914] AC 25, 48 (HL). Given the difference between the charge and the mortgage explained in the text, it should be obvious that the mere chargor does not have, since he does not need, *any* sort of right to redeem (i.e. to a retransfer of) the title.

²¹ Importantly, however, see the discussion about the nature of the mortgagor's rights that concludes this Section.

operates. The charge merely brings about a proprietary earmarking of the collateral for the prior payment of the charged debt, while leaving the collateral within the ownership of the chargor.

2. The distinctions — ignored

Sadly, this fundamental mistake about the nature of a charge appears to be present in every single one of their Lordships' speeches. Lord Nicholls states that "unlike the non-charged assets, the *charged* assets belong to the debenture holders to the extent of the amounts secured."²² This way of putting the matter invites both types of confusion the reader was warned against. During the currency of a *mortgage*, title to the collateral "belongs" outright (and not just "to the extent of the amounts secured") to the mortgagee, though it might be redeemed by the mortgagor. However, during the currency of a *charge*, title to the collateral is only encumbered by the property rights of the chargee "to the extent of the amounts secured". The ownership/property confusion holds the door open to the mortgage/charge confusion. It then becomes possible to claim that there is "nothing inherently surprising in Parliament deciding that in future the proprietary interests of a debenture holder in his fund, that is, the charged assets, shall be eroded to the extent of the claims of the preferential creditors without making any similar incursions in respect of liquidation expenses."²³ This, surely, is mistaken. If Parliament has provided (a) that liquidation expenses rank ahead of preferential claims and (b) that preferential claims have priority over the claims of the floating charge holder, and (c) if the creation of a floating charge — especially as contrasted with a mortgage — does not split up the debtor's estate into two separate funds, then it necessarily follows that (d) Parliament has provided that liquidation expenses would have priority over the floating charge holder's claims with respect to the distribution of the debtor's estate. It is not possible to affirm (a), (b) and (c) while denying (d).

Lord Hoffmann's speech is also troubling. He asserts that "the assets subject to the floating charge form a separate fund [because they] belong beneficially to the [charge]-holder... The company has only an equity of redemption; the right to *retransfer* of the assets when the debt secured by the floating charge has been paid off."²⁴ Could his Lordship have forgotten the truth he himself had reminded us of not long ago, that a "charge is a security interest created *without any transfer of title* or possession to the beneficiary"?²⁵ A chargor does not have the right to a retransfer because he has conveyed nothing, so there is simply nothing to retransfer.²⁶ It is also because the chargor has conveyed nothing and hence requires no right to any retransfer that he retains no equity of redemption. On the assumption that, as Lord Hoffmann states, the equity of redemption amounts to the right to a *retransfer* of title upon discharge of the secured loan, how could the chargor have only an equity of

²² At [16] (original emphasis).

²³ At [16].

²⁴ At [29] and [30] (emphasis added).

²⁵ *Re BCCI (No. 8)* [1998] AC 214, 226 (emphasis added).

²⁶ Repayment of the secured loan simply extinguishes the encumbrance upon the debtor's title to his property that is the charge.

redemption in the assets in which, as his Lordship also acknowledges, he *retains* title?²⁷

As before, this confusion appears to lead to error: “If A has priority over B in respect of payment out of the proceeds of Blackacre and B has priority over C in respect of payment out of the proceeds of Whiteacre, why does it follow that A has any right to payment out of Whiteacre?”²⁸ Here is the answer to his Lordship’s rhetorical question: in this context, Whiteacre is the name given to one corner of Blackacre. The creation of a *mortgage* just might split up the debtor’s estate into Blackacre and Whiteacre. The creation of a *charge* merely sets aside one part of the estate that is Blackacre for a particular purpose, and sub-classifies this part as Whiteacre. However, Parliament has provided that A is to be paid out of the proceeds of Blackacre (*as a whole, not merely some subset of it*) before B gets anything, and that B is to be paid in full before even a penny from the proceeds of Blackacre goes C’s way.²⁹ Hence Parliament has required that A be paid out of the “proceeds of Whiteacre” (a mere subset of the proceeds of Blackacre), and paid in priority to C.³⁰

Ironically, this conclusion receives further confirmation at the start of the leading speech. Lord Millett begins by pointing out quite correctly that “the real question is whether the expenses of a winding up are payable out of the charged assets at all. If they are, there is no doubt that they are payable in priority to the claims of the charge holder.”³¹ With respect, however, what follows in his Lordship’s speech is more difficult to defend.

In discussing, let it be recalled, the effect of the grant of a floating charge, Lord Millett appears indiscriminately to use authorities dealing variously with charges and mortgages. In explaining the nature of the charge, he starts a sentence by quoting James LJ in *In re Regents Canal Ironworks Co, Ex p Grissell*³² that the charge holders are creditors “to whom the [charged] property belong[s] with a specific right to the property for the purpose of paying their debts”. Lord Millett continues that “[s]uch a creditor is a person who”, and then quoting James LJ in *In re David Lloyd & Co.*,³³ “... is to be considered entirely outside the company, who is merely seeking to

²⁷ In fact Lord Hoffmann committed the same mistake in *Re BCCI (No. 8)* [1998] AC 214, 227 in relation to charge-back where his Lordship, verging upon self-contradiction, said that “[t]he depositor would retain an equity of redemption and all the rights which that implies. There would be no merger of interests because the depositor would retain title to the deposit subject only to the bank’s charge. The creation of the charge would be consensual and not require any formal assignment or vesting of title in the bank.”

²⁸ At [27].

²⁹ This is to be read subject to the comments made in the Conclusion, below.

³⁰ This is why their Lordships’ lengthy worrying about the statutory antecedents of IA, ss 40 and 175 is little more than misleading distraction. Of course Parliament, having provided that winding-up expenses ranked ahead of preferential claims, and that preferential claims ranked ahead of the floating charge holder’s claim, did not then have any need to spell out in addition that winding-up expenses would also rank ahead of the floating charge holder’s claim, any more than it needed to spell out that winding up expenses would rank ahead of general unsecured creditors, or ahead of statutorily deferred claims, or (in case there was a surplus) ahead of the claims of shareholders.

³¹ At [41].

³² (1877) 3 Ch D 411, 427 (CA).

³³ (1877) 6 Ch D 339, 344 (CA).

enforce a claim, not against the company, but to his own property”.³⁴ However, the *Regents Canal* case concerned a charge, and James LJ — despite confusing the issue somewhat by talking about the charged property “belonging” to the chargee — spelt out clearly that the latter’s interest in the property is restricted merely to a *specific right* to the property *for the purpose of paying their debts*. This is a correct description of the effect of a charge.³⁵ By contrast, the *David Lloyd* case concerned a mortgage, and James LJ rightly noted there that the mortgagee, standing altogether outside the debtor’s estate, merely seeks access to property the title to which is vested in him. So how could Lord Millett move from charge to mortgage in the same breath as if they were no different, when he himself had reminded us not long ago that the “difference between them is that a mortgage involves a transfer of legal or equitable ownership to the creditor, whereas an equitable charge does not”?³⁶ What is more, the distinction is particularly difficult to miss in this context, since *David Lloyd* involved a foreclosure action by the mortgagee. However, foreclosure simply “is not a remedy for chargees: a charge involves no conveyance to the chargee so there is no outright transfer held in suspense while the chargor remains in good standing”.³⁷ So how could *David Lloyd* possibly be an authority on the nature or effect of a charge?

3. Whither consistency of principle in insolvency law?

It appears to Lord Millett that “there are two distinct funds: (i) the proceeds of the free assets which belong to the company... and (ii) the proceeds of the assets comprised in the floating charge which belong to the charge holder to the extent of the security...” These are, he says, “two distinct funds which have not been pooled [and] which belong to different parties”.³⁸ With respect, however, how could there be two distinct funds, when, as Millett J himself had recently taught us, “[t]he mere creation of a [charge] over a company's assets does not deplete them. By charging its assets the company... does not deplete its assets or diminish their value”?³⁹ Given that this is so, what does the second fund, the fund *not* belonging to the chargor, consist of? It could not consist of the charged assets, since the chargor’s assets remain “undepleted” despite the creation of a charge (i.e., since the ownership of the charged assets remains in the chargor’s estate). So what otherworldly substance is the so-called floating charge fund made out of?

“The significance of the floating charge”, Lord Millett declares in *Re Leyland Daf*, is “not that it alters priorities for payment out of a single fund, but that it brings a second fund into existence with its own set of priorities.”⁴⁰ Once again, however, how could this be, given that, “by charging its assets the company appropriates them to meet the liabilities due to the secured creditor and adversely affects the rights of other creditors in the event of insolvency. But it does not deplete its assets... All it loses is the ability to apply the proceeds otherwise than in satisfaction of the secured debt.”⁴¹ The

³⁴ At [51].

³⁵ However, much of the remainder of the Court of Appeal judgment in the *Regent’s Canal* case is marred by the same misunderstanding of the nature of a charge being explored here.

³⁶ *Re Cosslett (Contractors)* [1998] Ch 495, 508 (CA).

³⁷ Bridge, *Personal Property Law*, 186.

³⁸ At [62] and [88].

³⁹ *Re MC Bacon* [1990] BCLC 325, 340h.

⁴⁰ At [81].

⁴¹ *Re MC Bacon* [1990] BCLC 325, 340h.

creation of a charge, Millett J told us in *Re MC Bacon*, entails the loss not of the charged assets but merely of the ability to use the proceeds of those assets except for the payment of the secured loan in priority to others. So how in *Re Leyland Daf* could he now be saying exactly the reverse, viz., that the grant of a charge does not (merely) fix the priority of payments to creditors but in fact bifurcates the chargor's assets into separate funds owned by different people? And if a charge does do this, then how is it different, as Millett LJ in *Re Cosslett* acknowledges it is, from a mortgage, which *would* remove the title to assets altogether from the debtor's estate?⁴²

We should note a second possibility, that a separate fund belonging to the chargee comes into existence when a charge is enforced. However, we know that enforcement of a charge does not involve a disposition of the company's property.⁴³ We should be careful, given the need for consistency with the rest of the law, about how we understand this point. There is no change in the beneficial *ownership* of the 'fund' constituted by the company's property at any point during the process by which a chargee (a person with a beneficial *interest* in the company's property) comes to control the assets subject to the charge, or the proceeds of their realisation, at a time when he is entitled to do so. The enforcement of a charge culminates in the collateral or its proceeds — contained at all times in the same one fund consisting of the rest of the company's property — being eventually applied towards discharging the secured debt. There is no change in the ownership of any part of this fund, right up to the point where the debt is satisfied. At the point where the debt is satisfied, a part of the fund is of course transferred to the chargee in his own right (for example, by being deposited in his bank account) and so becomes owned by him.⁴⁴ At the same point, however, the liability of the company is also extinguished *pro tanto*, as, importantly, is *the encumbrance upon its title to its property that is the charge*.⁴⁵ It follows that at no point *during the lifetime of the charge itself* is there any change in the beneficial ownership of the charged property, since the change in ownership of (some part of) the fund also marks the *pro tanto* annihilation of the charge. This shows that all that the chargee has with respect to the 'fund', consisting of the company's property left undepleted despite the grant of a charge, is the right to be repaid what he is owed from

⁴² [1998] Ch 495, 508. The inconsistency between [Millett J's judgment in *MC Bacon (No 1)* and Lord Millett's speech in *Leyland Daf* has been noticed by others. In *Re Nurkowski (A Bankrupt)* [2005] BPIR 842, this inconsistency was drawn to the attention of His Honour Judge Weeks QC (sitting as a deputy High Court judge) by Stephen Davies QC, who however found a way of distinguishing the cases on other grounds and was thus able to remark with some relief: "Fortunately I do not think I have to decide between two speeches of such an eminent authority."

⁴³ See e.g. *Re Margart* [1985] BCLC 314 (Supreme Court of New South Wales).

⁴⁴ How else would the secured debt be discharged except by vesting in the creditor beneficial ownership of property for this purpose? On the current interpretation of the law, there is no violation of IA, s. 127 at this point since the right to have this brought about was precisely what was granted to the chargee when the charge was created. The company's title to its property was always burdened by the liability to have some of that property applied for the prior payment of the chargee, so there is no "disposition" of that property when it is applied thus.

⁴⁵ So e.g., repayment of fifty percent of the secured loan decreases the encumbrance upon the company's title to the collateral (i.e. the extent to which the collateral and its proceeds are earmarked for the prior discharge of the secured loan) by fifty percent. One can be a *secured* creditor to no greater an extent than one is a *creditor*. Incidentally, note also that there is no diminution in the *net* value of the company's estate, since the loss in the value of the fund consisting of its property is matched by an exactly corresponding decrease in its liability. (This is subject to issues concerning synergetic value discussed in the next Section.)

some part of it in *priority* to other creditors. And we have it on rather good authority that “[q]uestions of priority arise only between interests which compete with each other for payment *out of the same fund*.”⁴⁶

There does appear to be little room for doubt. At no point in the life cycle of a charge is a separate fund created. As explained, in fact, the existence of the charge and the existence of “a distinct fund belonging to the charge holder” are *mutually exclusive*, since the creation of the latter *pro tanto* destroys the former. It follows that a mere charge can never — though we have so far left open the possibility that a mortgage may — create a fund of assets separate and distinct from the debtor’s assets. A charge simply allows the chargee to look to the charged assets and their proceeds to discharge the indebtedness in priority to the claims of unsecured creditors. And of course it is meaningful to talk about the priority between the chargee and the unsecured creditors only if they are competing for the *same* assets, i.e. assets of the chargor, which include the charged assets.

4. Wrong even with respect to mortgages

Having reached this point, we have outgrown the need for the heuristic focus on the distinction between charges and mortgages. Equity has long taught us that the mortgagee is no more owner of the collateral than is the chargee. It is the mortgagor’s equity of redemption that constitutes the most extensive bundle of property rights, not the bare title conveyed by way of security to the mortgagee.⁴⁷ “From the outset of the mortgage, equity regards the mortgagor as the ‘true’ owner of the [collateral], subject to the mortgage.”⁴⁸ Replicating what happens with a charge, at no point — earlier than the one at which the secured loan is repaid — is beneficial ownership of some part of the ‘fund’ hitherto owned by the mortgagor vested in the mortgagee. We can test this, here as in the context of the charge, by asking who benefits from any increase in the value of the collateral. If the secured creditor were (co-)owner of the collateral, he would benefit (proportionally) from any such increase, and might even receive more than he was owed, were there to be a sufficient rise in the value.⁴⁹ However, any suggestion that the mortgagee could benefit, over and above the secured amount, from such an increase *at any point during the currency of the mortgage* would be absurd.⁵⁰ What the mortgagee does have, right up till the very moment when the secured debt is satisfied, is the right to be repaid from the proceeds of the collateral not a penny more than what he is owed *in priority to* other creditors, and it is difficult to fault Lord Millett’s statement that “questions of priority arise only

⁴⁶ See e.g. at [81] and also at [74] (Lord Millett) (emphasis added). See also *Boscawen v Bajwa* [1996] 1 WLR 328 (CA).

⁴⁷ See e.g. *Fairclough v Marshall* (1878) 4 Ex D 37 (CA).

⁴⁸ William Fisher, *Fisher and Lightwood’s Law of Mortgage*, 11th edn (London, 2002), 768, citing *Re Wells* [1933] Ch 29 (CA).

⁴⁹ This, in fact, is how the creditor’s interests under a charge are distinguished from ownership interests in the well known cases where unpaid sellers of raw material have attempted to ‘retain’ title, by way of security, in the goods manufactured out of that raw material. See e.g. *Clough Mill Ltd v Martin* [1985] 1 WLR 111, 119-120 (CA) (Robert Goff LJ).

⁵⁰ That is, at any point until the mortgage terminates, e.g. by foreclosure. The mortgagee may of course benefit from a rise in the value of property that has in fact been handed over to him, not by way of *security*, but instead by way of *repayment* of the secured loan. However, this property is *no longer part of the collateral*, and thus no longer within the ambit of the mortgage.

between interests which compete with each other for payment out of the same fund”. It follows that the conveyancing device of the transfer of title to the creditor does not remove beneficial ownership of the mortgaged assets into a distinct fund belonging to the creditor any more than does the earmarking of property involved in the creation of a charge. The separate funds fallacy remains a fallacy whether one is considering a charge or a mortgage.

The conclusion, difficult though it be, is hard to avoid. On this point alone, the *Leyland Daf* decision already appears to be “a complete muddle”.⁵¹ The House of Lords claim for charges an effect not brought about even by the creation of a mortgage. In the process, the judgment appears to misuse authorities, and appears to confuse property with ownership, charges with mortgages, and the right to extinguish the encumbrance that is the charge with the equity of redemption. What is worse, at least two of their Lordships contradict clear statements of law they themselves have made in the recent past.

THE FUNCTIONAL NATURE OF THE *FLOATING* CHARGE

The discussion so far has proceeded on the basis of the charitable assumption that there is no relevant difference between a fixed charge and a crystallised floating charge. Their Lordships appear to accept this assumption as fact, and it is possible that others unreflectively share this belief. We should now note that the assumption is false.⁵² No one aware of the empirical context in which the floating charge is deployed by institutional lenders⁵³ would make the mistake of accepting it. In order to test whether a crystallised floating charge should be regarded as no different from a fixed charge, we need to understand whether such creditors use the floating charge for the same reasons that they use the fixed charge. In fact, they do not. The difference in the uses of the two types of charge is pithily captured thus by one of the most distinguished bankruptcy scholars in the common law world: “The fixed charge for priority; the floating charge for control.”⁵⁴ The discussion in this Section is aimed at testing their Lordships’ assertion that allowing the expenses of the winding-up to rank ahead of the floating charge holder’s claim would constitute an unacceptable “major additional incursion” into and “encroach[ment] upon” its priority interests.⁵⁵ However, the purpose of taking a floating charge, unlike that of acquiring a fixed charge, is *not* to ensure priority for its holder. It follows that it would constitute no objectionable incursion into or encroachment upon the legitimate interests of the floating charge holder for the expenses of the winding-up to rank ahead of its claim.

⁵¹ To borrow from Lord Hoffmann at [37], speaking, ironically, of an essentially correct passage from *In re Barleycorn Enterprises* [1970] Ch 465.

⁵² For Parliament’s statement that once a floating charge, always a floating charge, see IA, s 251.

⁵³ As was the case here; the chargee is a Dutch foundation representing a syndicate of banks.

⁵⁴ Jay Westbrook, “The Control of Wealth in Bankruptcy” (2004) 82 *Texas LR* 795 (hereafter, “Westbrook, “The Control of Wealth in Bankruptcy””), reporting an adage familiar to British bankers. The “control” which is crucial to the distinction between fixed and floating charges and which is referred to in the quotation is, as the following discussion emphasises, that by the chargee not of the charged *assets* (see e.g. *In re Spectrum (in Liquidation)* [2005] UKHL 41, [2005] 2 AC 680, [138]-[139], *per* Lord Walker) but of the debtor’s company’s *management*. See also Mokal, *Corporate Insolvency Law – Theory and Application* (Oxford, 2005), Ch 6, on which the following discussion draws.

⁵⁵ At [16] and [17].

1. Doctrinal facts and empirical proof

That the floating charge is not taken to ensure priority can be brought out by contrasting it with a fixed charge, a priority based security with which the floating charge is invariably combined in debentures.⁵⁶ The contrast may be made in three steps. First, the fixed charge *encumbers* the assets subject to it, such that unilateral attempts by the debtor to put it beyond the ambit of the charge do not defeat the charge holder's rights. With an uncrystallised floating charge, however, the debtor may deal with the charged assets and might even put them beyond the ambit of the charge without the chargee's consent, as long as this is done in the normal course of its business.⁵⁷ This has obvious consequences for the identity and quantum of assets that remain covered by the charge upon the happenstance of its crystallisation. Secondly and following from the fact that assets subject to a fixed charge are permanently appropriated for the payment of the secured debt, the holder of this sort of charge enjoys *priority* in the proceeds of sale of the collateral over all of his debtor's other creditors. The floating charge, on the other hand, ranks behind not only a later fixed charge over the same assets, but also behind statutory preferential claims. After the coming into force of the relevant provisions of the Enterprise Act 2002, the categories of preferential creditors have shrunk.⁵⁸ However, a particular proportion of the value of the collateral subject to a floating charge has been 'ring-fenced' for general unsecured creditors,⁵⁹ leaving the floating charge holder's position no better off.⁶⁰ Thirdly and finally, it follows from the first two points that a fixed charge performs the vital function of allowing its holder to tell how much collateral the creditor has been offered. This is essential in order for the creditor to carry out a *risk assessment* on the loan, which in turn allows it to determine the appropriate interest rate and other conditions for the loan. As for the floating charge, however, the creation of subsequent fixed charges and the accumulation of new preferential claims can dilute the security, as can the debtor's ability to alienate the collateral free of the charge. So the floating charge holder cannot even know exactly what assets it has security over, nor what value they have to it!

In view of these well-known facts about the floating charge, it is hardly surprising that in general, the priority of this charge does not enhance the recoveries of its holder. This is demonstrated by the available empirical evidence as to the recoveries of various classes of creditor in insolvency proceedings.⁶¹ Important for our purposes is

⁵⁶ For empirical evidence, see e.g. Julian Franks and Oren Sussman for the DTI; see *The Cycle of Corporate Distress, Rescue and Dissolution* (IFA Working Paper 306, 2000) (hereafter, "*Cycle*"), at 9 Table 4.

⁵⁷ This is another way of saying that the assets subject to a floating charge are not finally appropriated as security for the payment of the secured debt until the charge crystallises; see e.g. *In re Spectrum Plus (in Liquidation)* [2005] UKHL 41, [2005] 2 AC 680, [111] (Lord Scott) and [138]-[139] (Lord Walker).

⁵⁸ Enterprise Act, s 251.

⁵⁹ See IA, s 176A.

⁶⁰ See also IA, Sch B1, para 99(4), which grants the administrator the power to subordinate the claim secured by the floating charge to new monies advanced to finance the administration.

⁶¹ This generally derives from the annual Surveys of its members by the Association of Business Recovery Professionals; see e.g. ABRP, *9th Survey of Business Recovery in the UK* (22 November 2001); and recently, from *Cycle*.

the recovery rate for preferential creditors. It has been reported that preferential creditors receive an average of about thirty pence on the pound. We should recall that, under the ‘absolute priority rule’, creditors allocated a junior position in the statutory scheme for the distribution of insolvent estates are paid anything *only if* creditors senior to them have been fully paid off. This would appear to suggest that the average recovery on a floating charge, which ranks behind preferential claims, is zero.

However, such a conclusion would be a bit too hasty. Unsecured creditors rank even further behind preferential creditors, yet their recovery is above zero in at least some studies.⁶² So what *do* the holders of floating charges get in right of the priority of these charges? A closer look at the pattern of distribution of recoveries overall in insolvency proceedings provides interesting insight. Preferential creditors get back everything they are owed in just over twenty-five percent of insolvency proceedings, receive nothing at all in just under twenty-five percent of cases, and recover less than five pence on the pound in the remainder.⁶³ So not only is there no recovery at all under a floating charge in almost twenty-five percent of insolvencies (because preferential creditors receive nothing), virtually nothing is paid because of the floating charge in another fifty percent of cases (since preferential claimants get under five percent). And what about the twenty-five percent of insolvency proceedings in which preferential creditors receive their full amount, so that there would be a possibility of significant payments to floating charge holders as well? It is interesting to note that in these instances, the recovery rate for *unsecured* creditors is high, at almost twenty-five pence on the pound. This compares not unfavourably with average recovery rates for both secured creditors,⁶⁴ and certainly those for preferential ones. A likely explanation for this finding is that in such cases, a high return to preferential creditors indicates that the assets subject to the *fixed* charge have sufficient value to pay back all or almost all of the debt secured by the fixed charge. Now since the floating charge would almost always secure the *same* debt as the fixed one, having enough left over to pay off preferential creditors in full should be correlated with having sufficient value in the insolvent estate to meet a significant proportion of the unsecured debt as well (the debt secured by the floating charge already having been paid, entirely or almost entirely, under the fixed charge).

The evidence suggests, then, that the floating charge directs, at best, tiny amounts of insolvency value to its holders in three-quarters of all insolvencies, and does not transfer *any* wealth at all in another quarter of the cases.

It is very important to be clear about precisely what is being argued here. The argument is *not* that having a floating charge *never* increases the holder’s recoveries simply by virtue of the priority of this security. The evidence discussed above is by no means inconsistent with the proposition that in *some* insolvencies, the priority of the floating charge would cause a greater amount of value in the insolvent estate to be diverted to the holder of the charge than would be the case if the charge did not

⁶² While the more accurate work done by Franks and Sussman does find that the recovery for unsecured creditors is close to zero, the ABRP Survey reports that it is about seven pence on the pound.

⁶³ *Ibid.*, Chart 16.

⁶⁴ Reported in the Survey to be about fifty-three percent; *ibid.*

exist.⁶⁵ What is in fact being argued is that this is both rare, and for that reason, also unpredictable. *At the time that the debenture was being issued*, it would be very difficult to determine whether this particular debtor — should it later have to go through a formal insolvency proceeding — would constitute one of those rare cases where the priority of the floating charge would inflate its holder's recoveries. Put differently, institutional lenders considering whether to extend a loan would find it difficult *ex ante* to predict whether the eventual insolvency of this particular debtor would constitute the case where the priority of the floating charge was both, not *illusory* (because all of the debtor's property had been distributed to fixed charge holders and preferential creditors) and not *unnecessary* (because the debt secured by the floating charge had already been paid under the fixed charge). It follows that it would require great faith in the *irrationality* of institutional lenders which are repeat players in the market, which lend to tens of thousands of companies a year, and which have accumulated expertise in dealing with the consequences of default,⁶⁶ to attribute to them the intention of taking floating charges in the hope of gaining priority. It is more credible to assume that they would have long learnt from experience they would get back next to nothing on this type of security in at least seventy-five percent of insolvencies, and would not need to get anything on it in most of the remaining. In addition and crucially, they could not predict at the time of the conclusion of the loan agreement which of these groups a particular debtor would fall into, should it become insolvent.

It follows that while floating charges may *result* in some recoveries in some minute proportion of insolvencies, the dominant *reason* for their inclusion in a vast proportion of debentures that create security interests is not to ensure these rare and trivial recoveries.⁶⁷ From the creditor's point of view, recoveries by virtue of the priority of the floating charge, if and when they happen, are unpredictable windfalls. So it is not surprising that generally, floating charges are coupled with fixed ones.⁶⁸ The two perform different roles, and it is the *fixed* one which the creditor relies upon to provide him with priority (and encumbrance and the ability to carry out a risk assessment). This reasoning also allows us to understand that 'lightweight' charges⁶⁹ are not a special type of floating charge, but simply instances where the true nature of all floating charges is particularly obvious, viz., that it is relied upon for reasons that have nothing to do with securing priority.

⁶⁵ The present case might itself constitute just such an exception. Note, however, how misleading it would be to make empirical assumptions about how frequently the priority of a floating charge makes a difference to the recovery of its holder simply by looking at those cases in which clients seek advice from lawyers concerning particular insolvencies, still less by looking at the judicial decisions in this area. Obviously, lawyers will be consulted and cases litigated only in those cases where the priority of a floating charge is worth fighting about. It would be dangerous to generalise about the entire population of floating charge holders on the basis simply of this subset of self-selecting exceptional cases.

⁶⁶ See e.g. the discussion of 'central rescue units' in *Cycle*, examined below.

⁶⁷ For strong evidence that banks do not, when lending on the basis of debentures containing floating charges, rely on *any* recoveries they might make pursuant to such charges, see Mokal, *Corporate Insolvency Law*, 194, particularly fn. 30.

⁶⁸ See e.g. *Cycle* at 9 Table 4.

⁶⁹ See e.g. C. Rumbelow, "Mortgages by companies: A problem" [1989] *LSG* 32, and F. Odith, "Lightweight floating charges" [1991] *JBL* 49.

2. Floating fictions and facts

With respect, so much, then, for Lord Nicholls's explanation of why the floating charge is ubiquitous: "Financiers have money but want security for any loans they make. They wish to rank ahead of the company's unsecured creditors if the business does not prosper."⁷⁰ Our discussion of the evidence indicates that it would not be a rational strategy for a lender seeking to gain priority over other creditors in a useful way to rely on the floating charge. And seeking to enjoy priority merely over ordinary unsecured creditors would generally be an unwise goal, given that even preferential creditors get little or nothing in seventy-five percent of insolvencies, and given that in the remaining instances, the priority of the floating charge would be redundant in any case (the debt secured by the floating charge already having been paid under the fixed charge).

Readers might find it useful at this point to be provided with a quick description of the role that the floating charge *does* play. Such charges are taken either over the debtor's entire undertaking or over 'circulating' assets (raw materials, work in progress, stock in trade, receivables, certain types of machinery, etc.) which, while the debtor is commercially healthy, would best be left under the unhindered control of its management. To subject such assets to fixed charges would be to cripple the company's business, since, by their nature, the assets could not then be used in the company's business in the normal way without the chargee's consent. As noted, however, floating charges are always combined with fixed charges over assets which may be used in the debtor company's day to day business without requiring the chargee's consent. This is what provides priority to the chargee, should the debtor end up insolvent. When the debtor becomes distressed and the chargee judges its management no longer capable of running its business competently, the floating charge may be crystallised, behaving from that point on as if it were a fixed charge, and thus depriving the management of control even of the debtor's circulating assets. The crystallisation of the charge means that any subsequent unilateral attempts by the old management to pass the circulating assets out of the ambit of the security would fail. And since the crystallised charge has priority over *charging orders* and over *attempts to levy distress*,⁷¹ other creditors are discouraged from rushing to enforce their claims. The aim of all this is to increase the charge holder's recoveries, *not* by virtue of the priority of the floating charge, but instead by ensuring that the debtor's estate would not needlessly be dismembered when the company gets into difficulties. Instead, the debtor's business might be preserved as a going concern upon the displacement of its pre-distress management,⁷² and might either be turned around or else disposed of together in (what it is hoped would be) a value maximising manner. This increases the probability that the secured creditor would be paid, and paid in full.

⁷⁰ At [2]. However, in the light of the discussion to follow in the text, see his Lordship's comment at [3]: "Typically a floating charge extends to substantially all the assets of a company. On its face this gives a charge holder a high degree of control over the assets and fortunes of a company."

⁷¹ For an illustration of the latter, see *Re ELS Ltd* [1995] Ch 11.

⁷² Brought about by way of the appointment of an administrative receiver (before IA, a receiver and manager).

The floating charge, then, is a residual management displacement device.⁷³ It should be obvious that according priority to the expenses of winding-up over the claims secured by the floating charge would not impede this beneficial role of this charge in the slightest. In addition, since the floating charge, unlike the fixed charge, is not taken in order to secure priority over other creditors, it would be perfectly in order to provide that the assets covered by the floating charge should be used first to pay off the expenses of the winding-up. The holder of the floating charge would not have extracted this security for the purpose of benefiting from its priority position, and so would lose nothing that it had bargained for by finding itself subordinated to the liquidator's claim.

This negative argument — showing why it would not *harm* the floating charge holder to subordinate him to the expenses of winding-up — is reinforced by a positive argument in the next Section showing how such a subordination is in fact necessitated because the floating charge holder *benefits* from a properly conducted winding up.

THE HOLDER OF A FLOATING CHARGE AND A PROPERLY CONDUCTED WINDING-UP

One of the many curiosities of their Lordships' decision in *Re Leyland Daf* is that it insists on seeing liquidation proceedings merely as serving the private financial interests of a subgroup of the creditors of a company. The speeches repeatedly assert or imply that since winding up is little more than an orderly mechanism for the recovery and distribution of the company's "free" assets for the benefits of general creditors, it brings no benefits to floating charge holders, who therefore should not be expected to pay for it.⁷⁴ Their Lordships make no mention of a decision they made no more than seven months previously, confirming the long established proposition that liquidation proceedings also play another, much wider role.⁷⁵ Such proceedings are designed to result in benefits to a far broader range of interested parties, and do so even at the direct expense of the financial interests of the creditors of the particular company which is in liquidation.⁷⁶ Let us focus on the benefits brought by a properly conducted liquidation to the holders of floating charges as a group.

As part of the process of winding up, the liquidator wields statutory powers to investigate the conduct of directors, and if appropriate, to ask the court to discipline them. These powers include those for bringing fraudulent and wrongful trading actions, which may only be exercised by a liquidator, and those for bringing misfeasance actions, that, while also available to the official receiver and to creditors

⁷³ Under the pre-Enterprise Act 2002 law, the debtor company's management was usually displaced through the appointment of an administrative receiver (and before the Insolvency Act 1986, a receiver and manager). After the implementation of the 2002 changes, the usual mode of management displacement is to put the debtor in administration. This is a greatly abbreviated summary. The detailed analysis may be found in Mokal, *Corporate Insolvency Law*, 168-208; the question whether the floating charge still plays a useful role in the post-Enterprise Act world is considered at 219-223. For a flavour of the international debate about what the recognition of the floating charge by a bankruptcy system reveals about that system, see Westbrook, "The Control of Wealth in Bankruptcy".

⁷⁴ See e.g. at [31], [62], [77], and [89].

⁷⁵ *Re Pantmaenog Timber* [2003] UKHL 49; [2004] 1 AC 158. Lords Hoffmann, Millett and Walker graced the bench on both occasions.

⁷⁶ *Re Pantmaenog Timber* [2003] UKHL 49; [2004] 1 AC 158; at [79] (Lord Walker).

and contributories, may only be invoked with respect to a company undergoing a winding-up.⁷⁷ The liquidator also has (in common with the administrator) the power to ask for a reversal of transactions at an undervalue and of preferences.⁷⁸ All these statutory mechanisms work (to the extent that they do) in two ways. First, a successful invocation of any of these provisions results in recoveries from those against whom a court is persuaded to make an order. The rules governing the destination of these recoveries are complicated, but of the statutory provisions mentioned, only a misfeasance action may result in recoveries for the benefit of a floating charge holder.⁷⁹

Second and more importantly, however, the proper implementation of these statutory mechanisms reinforces commercial morality more generally amongst those operating and dealing with companies.⁸⁰ This is another way of saying that the due enforcement of these provisions creates a broad deterrence effect in the commercial community with respect to the prohibited actions on part of directors and others. And naturally, whoever participates most frequently in the commercial realm stands to gain the most from this reinforcement of commercial morality. It follows that the main beneficiaries of the deterrence effect created by properly conducted liquidations are institutional lenders as a group, who are the main commercial repeat players, and who also, as it happens, most frequently deploy floating charges. For example, a proper enforcement of the wrongful trading provisions creates *some* incentive for directors in general to invoke appropriate corporate rescue mechanisms at the right time rather than to trade their company into the ground. This increases the expected value of the recoveries made by all creditors, including floating charge holders. Similarly, a proper enforcement of the provisions avoiding transactions at an undervalue and preferences deters (to whatever degree) such transactions from being entered into in the first place, thus preserving assets for all the creditors as a group, including floating charge holders.⁸¹

It is of course perfectly possible to argue that these provisions do not work well enough. However, this would merely be an argument for making them work better, by, *inter alia*, providing for properly funded liquidations. It would certainly not be an argument for starving the liquidator even further of the funds he needs to pursue those who have violated these statutory provisions. This consideration is strengthened by the observation that Parliament has been keen to alleviate the funding problems faced by liquidators, and has recently attempted to do so by expanding the scope of liquidation expenses.⁸²

Another dog that did not bark in the *Re Leyland Daf* judgment was the administration regime introduced by the Enterprise Act 2002. If the expenses being claimed by the

⁷⁷ IA, ss 213, 214, and 212, respectively.

⁷⁸ IA, ss 238 and 239.

⁷⁹ See e.g. Rebecca Parry, “The Destination of Proceeds of Insolvency Litigation” (2002) 23(2) *Company Lawyer* 49.

⁸⁰ *Re Pantmaenog Timber*, at [47], [53] and [80].

⁸¹ A somewhat different point is made by Westbrook, “The Control of Wealth in Bankruptcy”, 802 fn. 14, who notes that “the policing of state secured-credit law [is] a job which history has left to bankruptcy law.”

⁸² Through an amendment to the Insolvency Rules 1986, r 4.218.

liquidator in this case had been incurred by an administrator under the new regime, there is no doubt that they would have had priority over the floating charge holder's claims.⁸³ If we remember that both liquidation and administration are collective procedures and that an administration proceeding may in effect be a substitute for a liquidation proceeding, it is difficult not to be struck by the perversity of their Lordships' decision in policy terms.

The arguments in this Section demonstrate that not to subordinate floating charge claims to the expenses of winding up is in fact to allow floating charge holders as a group to free-ride at the expense of other creditors, taking the benefits flowing from liquidation proceedings without paying for them. They also demonstrate how difficult it is not to see their Lordships as rowing in the opposite direction from the Legislature, apparently striving — in the face of the formidable doctrinal difficulties and the overwhelming evidence as to the functional nature of the floating charge discussed above — to make the proper funding of liquidation proceedings that much more difficult.

CONCLUSION

Their Lordships' speeches in *Re Leyland Daf* cut huge swathes across property and corporate insolvency law. Without really saying so, have their Lordships abolished the distinction between mortgages and charges? Not only do they seem to assume that there is no such distinction, but the new, unified security interest envisaged by them, in apparently vesting the beneficial ownership of the collateral in the *creditor*, resembles the sort of mortgage that used to exist at law some hundred years ago, before equity intervened to insist that it was the *debtor's* equity of redemption that constituted beneficial ownership.⁸⁴ Presumably, the grant of a charge now *does* deplete the company's assets, since some of these assets are now removed into a

⁸³ See IA, Schedule B1, para. 99 and also para. 70. The relevance to their Lordships' decision of the recent amendments to the insolvency legislation go further, however. The new legislation more or less consistently refers to the assets subject to a floating charge as "property of the company". For example, IA, s. 176A, introduced by the Enterprise Act, "applies where a floating charge *relates to property of the company*" (subsection 1; emphasis added), and speaks of "the company's net property" as "the amount of *its* property which would, but for this section, be available for satisfaction of claims of holders... any floating charge created by the company" (subsections 2, 3, 6 and 7; emphasis added). In Schedule B1, para. 70, authorising the administrator to deal with the property subject to a floating charge, describes the proceeds of any disposal of such property as the "property of the company which directly or indirectly represents the property [subject to a floating charge]". See also e.g. IA, 72A, and Schedule B1, paras. 14, 35, 36, 37, 96, 97, etc. It would serve no useful purpose to multiply such examples, but it is, quite simply, not open to doubt — unless some objection be taken that "the company's property" in the recent legislation refers to something other than "the company's assets" in the older parts of the legislation (e.g. IA, ss. 40, 115 and 175) — that Parliament gave assent to the relevant provisions of the Enterprise Act on the understanding that assets subject to a floating charge remain the company's assets.

⁸⁴ It is of interest to note that some lower courts appear to be reading the speeches in *Leyland Daf* in a fairly restrictive way; see e.g. *Ultraframe (UK) v Fielding* [2005] EWHC 1638, [1397]-[1405], where Lewison J rejected a submission based on *Leyland Daf* that assets subject to a floating charge are owned by the chargee, and that the charger only "owns" an "equity of redemption". In fact, his Lordship noted at [1403], it is the chargor who is the equitable owner of the charged assets. See also the next footnote.

distinct fund not belonging to the chargor?⁸⁵ Since the ‘chargee’ *is* the beneficial owner of the collateral in the post-*Leyland Daf* world, he presumably has the right to take possession of the collateral? And should he not be able now to benefit from an increase in the value of the collateral like any (co-)owner, recovering, in the appropriate case, even more than the amount secured? (And if all he gets is what he was owed, no matter how far the value of the collateral might rise, then in what sense is he a (co-)owner, rather than merely the beneficiary of a particular priority position in being repaid up to a fixed maximum amount from the proceeds of sale of *another’s* property?) If the ‘chargor’ now only retains an equity of redemption, then the ‘chargee’ presumably has the right to foreclose? If floating charge holders as a group should not be required to pay for winding-up proceedings because such proceedings only benefit unsecured creditors, then presumably their Lordships were wrong to have held recently that each such proceeding brings benefits to a much wider group which nevertheless must be paid for by the creditors of that particular company?

Instead of creating such abundance of confusion — and apparently acting inconsistently both with the functional nature of the floating charge and the manifest intention of Parliament to provide for better funded insolvency proceedings — their Lordships might have chosen to take a different tack. They might have reminded the broader legal community that the insolvency legislation, not having been written at the same time or by the same people or by logicians or by omniscient beings able to anticipate all possible contingencies, is not consistent in its use of terminology. It speaks about “the company’s property” or the “assets of the company” without providing statutory definitions of these terms, and without any discernable effort to use the same terms in the same way from provision to provision. Two interpretive consequences follow. First, these terms are presumptively to be read as taking their meaning from the general law. And second, the inevitable and multiple inconsistencies in usage are to be dealt with only by keeping in full view the purposes being served by the legislation.

Their Lordships could have taken into account the fact that, over the years, the legislation has come to assign a broad range of socially important roles to collective insolvency proceedings, including liquidation. The liquidator must therefore be properly funded. Over the years, the legislation has also acknowledged the priority-independent nature of the floating charge by subordinating recoveries under it both to the expenses of winding up and to preferential claims. Fixed charges *are* priority based security, on the other hand, and the existence of this priority itself plays a crucial social role.⁸⁶ So it is right to protect that priority by subordinating it to nothing more than the costs of administering the property subject to the fixed charge.

⁸⁵ In fact, and in contradiction with this implication of *Leyland Daf*, the Court of Appeal has held, relying on *MC Bacon (No 1)*, that the grant of a charge does not deplete the chargor’s estate; see *Department for Environment Food and Rural Affairs v Feakins* [2005] EWCA Civ 1513, [52]-[53] and [72]. *Leyland Daf* does not appear to have been cited to the court.

⁸⁶ It is beneficial for *all* those dealing with companies for some creditors to bargain for priority by way of *fixed* charges, so there are very good reasons why fixed charge holders should not be subordinated to liquidation expenses; these reasons may be found in detail in Mokal, *Corporate Insolvency Law*, Ch 5; see also “The Search for Someone to Save: A Defensive Case for the Priority of Secured Credit” [2002] *OJLS* 687.

Taking this view requires the words in the legislation to be read sensibly. The courts have long supplemented the statutory wording in this context, for example, by reading “assets” in section 40(2) of the Insolvency Act and section 196(2) of the Companies Act 1985 as not including fixed charge assets, even though the statute explicitly contains no such restriction.⁸⁷ Their Lordships might equally sensibly have chosen to read, for example, section 115 of the Insolvency Act naturally, subject only to an exactly analogous supplementation. This approach would have provided an outcome defensible both in doctrinal and policy terms, and would not have required the misleading and ultimately fruitless trawl through the history of how the various bits of the insolvency legislation came, very imperfectly, to be thrown together.

It is submitted that in both principle and policy, *Leyland Daf* should not be allowed to stand. Therefore, it is now up to Parliament to undo their Lordships’ mistake.⁸⁸

⁸⁷ *In re Lewis Merthyr Consolidated Collieries* [1929] 1 Ch 498 (CA); *In re G.L. Saunders* [1986] 1 WLR 215.

⁸⁸ See the Company Law Reform Bill 2005, clause 868.