CASE REVIEW SECTION

Re Spectrum Plus Limited

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On 30 June 2005, the House of Lords delivered its eagerly awaited Judgment in the case of *National Westminster Bank plc v Spectrum Plus Limited and others*[1] and in so doing dashed the hopes of many banks that the earlier decision of Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd*[2] might be upheld despite the debate about the correctness of that decision which had centred largely upon the comments of Lord Millett in the *Brumark*[3] case.

The unanimous decision of the unusually large panel of seven Law Lords (overruling the similarly unanimous decision of the Court of Appeal) is of significance to financiers and lawyers for two reasons: First, because of its legal consequences in relation to the creation of fixed and floating charges over book debts and second, because, for the first time in English legal history,[4] their Lordships have expressly considered that they would have the power to overrule a previous decision with only prospective effect.

Fixed and floating charges over a company's book debts

The debenture granted by Spectrum Plus Limited to NatWest was, in material terms, no different to that relied upon by Barclay's Bank in the *Siebe Gorman* decision. In that earlier case, Slade J had held that a charge over book debts which required the company to pay the proceeds of the same into its account with the chargee bank upon which the company was then free to draw, created a fixed charge over the relevant book debts of the company. However, as UK readers will be aware, in February 2002, prompted by the terms of the Privy Council's decision in the *Brumark* case, the Crown issued a public statement to the effect that distributions made by insolvency practitioners after 5 June 2001 to banks in respect of charges where the chargor had been allowed an unfettered right to draw on the proceeds of the book debts without the specific consent of the chargee were liable to challenge from the Crown.[5]

In fact, in the *Spectrum Plus* litigation NatWest Bank forced the Crown's hand by issuing its own application against the company, for a Declaration that its charge over the company's book debts was 'fixed' and for an order that the liquidators of the company must accordingly account to them for the full amount of the book debt realisations. Like many duly appointed insolvency practitioners, the liquidators were withholding such proceeds in view of the Crown's recent public statement – indeed, shortly after the Crown issued its public statement, the Association of Business Recovery Professionals told its members not to make any distributions, or treat charges as floating charges, without the consent of the relevant banks and preferential creditors and, if consensus could not be reached, to make their own application for directions.[6] In the result, the liquidators took no active part in the proceedings, rather the argument was between the Bank on the one hand and the Crown Creditors[7] on the other.

At first instance, the Vice Chancellor dismissed the Bank's Application, holding that the Crown was correct in its submissions that the debenture,

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1 [2005] UKHL 41.

2 [1979] 2 Lloyd's Rep 142.

3 *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28; [2001] 2 AC 710.

4 The writer is unaware of any previous decision in which a majority of the House of Lords has reached such conclusion and the argument before their Lordships in relation to 'prospective overruling' in *Re Spectrum Plus Limited,* by the Crown Appellants, the Respondent bank and the Advocates to the Court, all proceeded on this basis.

5 'Statement on behalf of Inland Revenue, HM Customs & Excise and the Redundancy Payments Service (the Crown Departments): Distribution of proceeds of book debts subject to debentures where the Crown Departments are creditors.'

6 Technical Bulletin 50, May 2002.

7 The Crown Creditors being the Inland Revenue, HM Revenue and Customs and the Secretary of State for Trade and Industry.

although in material terms indistinguishable from that considered by Slade J in *Siebe Gorman*, created only a floating charge over the book debts and their proceeds.[8] Although his reasoning and analysis of the charge was obviously correct as a matter of principle, his decision to dismiss the Application at first instance was perhaps surprising given the discredited but binding precedent of the Court of Appeal's decision in the *New Bullas*[9] case. Although it is fair to note that, since the case was being run as a test case, the Bank was obviously not keen to advance the existence of the *New Bullas* precedent as a ground in support of its Application since any victory achieved on such grounds would simply have been ephemeral.

The Court of Appeal unanimously allowed the Bank's appeal for three independent reasons, the first and obvious one being the effect upon the Vice Chancellor of the existence of the *New Bullas* decision.[10] However, Lord Phillips MR, with whom the rest of the Court agreed, considered that, whilst the particular reasoning in *New Bullas* could no longer be supported, he would otherwise allow the Bank's appeal in any event because (i) the company's obligation to pay the proceeds of the book debts into a current account which was at any time (as a matter of contractual assumption) likely to be overdrawn operated as a repayment pro tanto of the company's debt to the chargee such that the company could not in fact use the proceeds for its ongoing business, and/or (ii) he considered that it would be wrong to overrule *Siebe Gorman* as it had been relied upon by banks in their dealings with corporate customers and their guarantors for many years.

The Crown's appeal from that decision came on for hearing before the House of Lords in late April of 2005. The Crown's case throughout, in a (very brief) nutshell, was that (i) the hallmark of a floating charge and a characteristic inconsistent with a fixed charge is that the chargor is free to use the assets which are subject to the charge and withdraw them from the security without the specific consent of the chargee, and that (ii) in paying the proceeds of its book debts into its ordinary current account facility with the bank, the company was thereby freely able to withdraw the debts from the security and use the same in the ordinary course of its business unless and until the bank gave proper notice to terminate the overdraft facility on the current account. Accordingly, the Crown submitted that the debenture in question should properly be characterized as a floating charge. The lead judgment on this issue was given by Lord Scott of Foscote and supplemented by Lord Hope of Craighead and Lord Walker of Gestingthorpe and all three adopted the Crown's reasoning. The remaining members of the panel all expressly agreed with their brethren and, accordingly, *Siebe Gorman* and *New Bullas* have now both been overruled.

It is also of note to readers of this publication that, during the course of its submissions, the Crown made reference to an article by Professor Sarah Worthington which appeared in a previous edition of this publication, entitled 'An "Unsatisfactory Area of the Law" – Fixed and Floating Charges Yet Again',[11] the substance of which was quoted with approval in the Judgments of both Lord Hope of Craighead and Lord Walker of Gestingthorpe.

Prospective overruling

Lord Nicholls of Birkenhead focused instead upon the prospective overruling issue, ultimately expressing the view that the House of Lords in exercise of its judicial function would not be trespassing outside its proper functions under the constitution if it decided in a particular case to depart from the normal principle of retrospectivity and engage in prospective overruling. Although there was some dissent regarding the extent of the circumstances in which such power could be exercised,[12] all of their Lordships agreed with the underlying principle that they would, in an appropriate case, be permitted to engage in prospective overruling.

This suggestion of overruling *Siebe Gorman* with only prospective effect had been put forward by the Bank as an intermediate possibility in the event that their Lordships were persuaded both by the Crown's submissions in relation to the incorrectness of *Siebe Gorman* and by the Bank's submissions in relation to

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8 [2004] EWHC 9 (Ch); [2004] 2 WLR 783.

9 *In re New Bullas Trading Ltd* [1994] 1 BCLC 485. In that case the Court of Appeal upheld a charge which had been drafted so as to purportedly create a fixed charge over the *debts* and a floating charge over their *proceeds* upon realisation by the company. The decision met with much academic criticism and in *Agnew v Commissioners of Inland Revenue* the Privy Council, in an appeal from the New Zealand Court of Appeal, considered that *New Bullas* had been wrongly decided, as book 'debts' cannot be commercially separated from their proceeds. However, whilst the Privy Council overruled *New Bullas* for the purposes of New Zealand law it of course could not formally overrule the same as a matter of English law.

10 [2004] EWCA Civ 670; [2004] 3 WLR 503.

11 (2004) 1 *International Corporate Rescue* 175.

12 See for example the Judgments of Lord Scott of Foscote and Lord Steyn who, whilst agreeing in principle with Lord Nicholls of Birkenhead, considered that such power would not be permissible in relation to questions of statutory intepretation.

the unfairness which, it was said, would result from previous reliance by banks, companies and their guarantors upon that decision. Since the Crown did not dissent from the basic proposition that their Lordships were empowered as matter of constitutional law to engage in overruling previous decisions with limitations on temporal effect, Advocates to the Court were appointed to argue the contrary position.

Their Lordships had been addressed in relation to the possibility of prospective overruling in previous appeals.[13] However, as far as their Lordships and all counsel involved in the case were and are aware, this is the first occasion upon which the House of Lords has elected to express a considered view upon the possibility of it having such jurisdiction, although their Lordships were not in fact persuaded by the Bank's submissions that this was an appropriate case in which to impose such temporal limitations upon the effect of their Judgment. It therefore remains to be seen what circumstances might be considered to justify the exercise of such jurisdiction, but in the words of Lord Nicholls of Birkenhead 'never say never' …

Conclusion

The House of Lords' decision is likely to have far-reaching implications, indeed *The Financial Times* recently reported that one estimate suggested that about 550 insolvencies were being held up awaiting the final ruling in the *Spectrum Plus* case and that other insolvency practitioners had said that this figure was 'probably conservative.'[14] Although the decision is no doubt unwelcome as far as the banks are concerned because of the priority implications of having only a floating charge rather than a fixed charge over the company's book debts, it will at least resolve those previously halted insolvencies where the relevant charge is in the same form. However, it is understood that a number of variant forms have been in use in the market and questions may still remain in some cases as to whether the relevant terms go far enough to create the hallowed 'blocked account' …

The above is only a cursory review of their Lordship's decision. A more in-depth analysis by the writer of the impact of the House of Lords' decision will follow in a subsequent issue of *International Corporate Rescue.*

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13 See for example *Rv Governor of Brockhill Prison, ex parte Evans* [2001] 2 AC 19.

14 *Financial Times,* Friday 1 July 2005, 'Law lords' insolvency repayment ruling is bad news for banks', by Nikki Tait and Vanessa Houlder.