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Gray and others v G-T-P Group Limited: Re F2G Realisations Limited (in liquidation) [2010] EWHC 1772 (Ch)

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Introduction

The recent decision of Vos J in *Gray and others v G-T-P Group Limited: Re F2G Realisations Limited (in liquidation)* considered whether an English law floating charge was exempt from the registration requirements of s. 395 of the (then applicable) Companies Act 1985 (the '1985 Act') for the reason that it came within the scope of the registration exemptions set out in the Directive on Financial Collateral Arrangements 2002/47/EC (the 'Directive') which was implemented in the UK by the Financial Collateral Arrangements (No. 2) Regulations 2003, SI 2003, 3226 (the 'Financial Collateral Regulations' or 'Regulations').

This case is of importance to practitioners as it is the first English law decision which provides some guidance on the scope of the registration exemptions of the Financial Collateral Regulations, in particular whether an English law floating charge would come within the scope of these registration exemptions.

Background and facts

F2G Realisations Limited ('F2G') was a retailer of laminated flooring and G-T-P Group Limited ('GTP') provided payment card related processing services to F2G. Amounts paid by F2G's customers using store debit cards would be paid into an account held by GTP with the Royal Bank of Scotland. F2G and GTP entered into a declaration of trust dated 22 June 2006 (the 'Declaration of Trust') setting out the terms on which the monies in the account held by GTP (the 'Trust Account') were to be dealt with. Pursuant to the Declaration of Trust, GTP, as trustee, would hold the monies in the Trust Account on trust for F2G, as beneficiary. GTP agreed to transfer the monies, at the request of F2G, to F2G and such payments would be made by GTP 'without any withholding, deduction or set-off'. The Declaration of Trust also contained provisions which stated that, upon the occurrence of certain

specified events (each a 'Trigger Event'), GTP was entitled to exercise rights of set-off and withdraw from the Trust Account sums which were properly due to it. The Trigger Events included, inter alia, (i) F2G's failure to comply with its payment obligations in respect of services provided by GTP; and (ii) the insolvency of F2G. Crucially, the Declaration of Trust was not registered as a charge under s. 395 of the 1985 Act.

In September 2006, F2G and GTP entered into a services agreement setting out the terms on which GTP would provide certain trade card services to F2G's customers (the 'Services Agreement'). The Declaration of Trust governed the treatment of any payments which were to be processed by GTP pursuant to the Services Agreement.

F2G went into administration on 21 July 2008. The administrators of F2G (the 'Administrators') terminated the Services Agreement and sought repayment from GTP of the monies which were standing to the credit of the Trust Account. It appears that it was agreed that a sum of GBP 15,000 plus VAT should be paid by the Administrators to GTP in respect of a termination fee for the termination of the Services Agreement on the basis that the remainder of the monies in the Trust Account would be paid over to the Administrators.

GTP were seeking to exercise their rights of set-off under the Declaration of Trust for the following amounts against the sum to be paid to the Administrators: (i) unpaid sums for operating fees prior to the administration; (ii) three months lost revenue resulting from the termination of the Services Agreement without notice; and (iii) the termination fee referred to above.

On 21 July 2009 the administration of F2G became a liquidation pursuant to Schedule B1 of the Insolvency Act 1986 (as amended). The liquidators made an application to the court seeking first a declaration that the Declaration of Trust is void against the liquidators as an unregistered floating charge and secondly an order for the payment to the liquidators of the sums standing to the credit of the Trust Account.

Issues and arguments

The parties agreed that the provisions of the Declaration of Trust had created some form of security over the property of F2G in favour of GTP. The first issue to be determined was whether the security created under the Declaration of Trust was a fixed or a floating charge.

GTP asserted that the provisions of the Declaration of Trust created a fixed charge over the monies in the Trust Account and that, as such, they were entitled to withhold the monies in the Trust Account and exercise their rights of set-off in relation to the sums owed to them by F2G.

F2G, on the other hand, contended that the Declaration of Trust had in fact created a floating charge over the monies in the Trust Account, and that such floating charge (being a registrable charge under s. 395 of the 1985 Act) was void for lack of registration in accordance with s. 396(1) of the 1985 Act.

GTP argued that even if the Declaration of Trust had created a floating charge over the property of F2G, this charge was not registrable under the 1985 Act as it comes within the scope of the Financial Collateral Regulations. GTP argued that the charge came within the definition of either a 'security interest' or a 'security financial collateral arrangement' under the Financial Collateral Regulations. Under Regulation 4(4) of the Financial Collateral Regulations, 'security financial collateral arrangements' are exempt from the registration requirements contained in the 1985 Act, and as a result of this, the floating charge would not be void for lack of registration.

Accordingly, the two key matters for Vos J to determine were:

- (a) what was the nature of the security interest created by the Declaration of Trust, was it a fixed or floating charge over the monies in the Trust Account in favour of GTP?
- (b) if the charge created was a floating charge, did such floating charge come within the scope of the Financial Collateral Regulations and therefore the exemption from registration under the provisions of the 1985 Act?

Analysis, applicable law and the decision

(a) Fixed and Floating Charges

The issue of whether a chargee holds a fixed or a floating charge becomes important on the chargor's insolvency. Upon the liquidation of a chargor's assets,

the holder of a fixed charge over specific assets of the chargor company, will have its debt repaid out of the proceeds of sale of the charged assets before all other creditors of the company. If the realised value of the charged assets is less than the amount of debt owed to the holder of the fixed charge, the fixed charge holder can claim the balance as an unsecured creditor of the company.

A floating charge holder, on the other hand, will only be repaid out of the proceeds of sale of the charged assets, after the (i) fixed charge holders; (ii) expenses of the insolvency; and (iii) claims of preferential creditors (these usually consist of employees with labour related claims), have been repaid. Furthermore, once these parties and expenses have been paid, a certain portion of the proceeds available to the floating charge holder must be set aside and made available to settle the claims of unsecured creditors of the company. The floating charge holder will only be entitled to any sums remaining after these 'ring fenced' funds have been set aside.¹

There is a well established line of English case law authority on whether a charge should be characterised as a fixed or floating charge. In making a characterisation, the courts will look at the commercial reality of the arrangement and not simply at the label given to a charge by the parties concerned.

The current English law position in relation to the characterisation of fixed and floating charges is summarised in the House of Lords case, *National Westminster Bank v Spectrum Plus* [2005] UKHL 41. Under the Spectrum test, the courts must consider:

- (i) what is the nature of the rights and the obligations that the parties had intended to grant to each other in respect of the security arrangement; and
- (ii) what is the correct legal categorisation as a matter of law to describe the rights and obligations identified under (i) above.

(b) Did the Declaration of Trust create a fixed or a floating charge?

In determining whether the Declaration of Trust had created a fixed or a floating charge in favour of GTP over the monies in the Trust Account, the court applied the two stage test established in the Spectrum case.

The court held that the parties had intended that the Trust Account operate as a simple trust account, the purpose of which was to act as a conduit through which F2G could collect the monies spent by those customers who used their store debit cards. Pursuant to the terms of the Declaration of Trust, F2G was

Notes

1 The 'ring-fenced' portion is calculated as 50% of the first GBP 10,000 of net floating charge realisations and 20% of the remainder, subject to a cap of GBP 600,000.

expressly entitled to call for the monies in the Trust Account at any time and GTP had no right to withhold such monies or exercise any rights of set-off save in certain circumstances provided for in the Declaration of Trust – the occurrence of a Trigger Event.

In considering the second limb of the test, Vos J stated that the essential element in determining whether a charge was fixed or floating was the chargor's ability to, without the chargee's consent, control and manage the charged assets. The judge considered that, in reality, GTP had no real control over the Trust Account and its only involvement was in an administrative capacity. F2G had ultimate control over the monies in the Trust Account as it was, under the terms of the Declaration of Trust, entitled to request at any time, without requiring GTP's consent, that GTP pay over to it all of the monies standing to the credit of the Trust Account. If the charge was a fixed charge, GTP would have had legal control over the monies in the Trust Account and would be able to prevent F2G from dealing with the monies (similar to the operation of a blocked account). However, GTP's only element of control arose when the floating charge effectively crystallised once one of the Trigger Events had occurred. The occurrence of such Trigger Event would entitle GTP to exercise its rights of set-off and withdraw the monies from the Trust Account which were properly due to it. Prior to the occurrence of a Trigger Event, GTP did not have any right of set-off or to withhold the monies in the Trust Account or any form of control over and above the control they exercised by virtue of their role as administrators of the Trust Account.

Accordingly, the court determined that the charge created by the Declaration of Trust was a floating charge over the monies in the Trust Account in favour of GTP. As the Declaration of Trust had not been registered as required under the 1985 Act, GTP sought to argue that the floating charge came within the scope of the Financial Collateral Regulations and was therefore exempt from the registration requirements.

(c) Was the floating charge a 'security interest' or a 'security financial collective arrangement' under the Financial Collateral Regulations?

The Financial Collateral Regulations were introduced in order to ensure the efficient operation of financial markets so that large financial institutions could enforce 'collateral' which may have been granted to them in respect of short term borrowings to counterparties in the financial markets. The Regulations ensure that, amongst other things, financial institutions who hold this collateral are comfortable that they will be able to enforce their security without being concerned that the security is void for lack of registration under s 395 of the 1985 Act and, as of 1 October 2009, the similar replacement provision at s. 870 of Companies Act 2006.

Regulation 4(4) provides that an arrangement which comes within the definition of a security financial collateral arrangement under the Regulations is exempt from registration under section 395 of the Companies Act 1985.

'Security financial collateral arrangement' is defined as being:

'an agreement or arrangement, evidenced in writing, where: (a) the purpose of the agreement or arrangement is to secure the relevant financial obligations owed to the collateral-taker, (b) the collateral-provider creates or there arises a security interest in financial collateral to secure those obligations; and (c) the financial collateral is delivered, transferred, held, registered, or otherwise designated so as to be in the possession or under the control of the collateral taker or a person acting on its behalf.'

Under the Regulations, 'security interest' includes:

'a charge created as a floating charge where the financial collateral charged is delivered, transferred, or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf; any right of the collateral provider to substitute equivalent financial collateral or withdraw excess financial collateral shall not prevent the financial collateral being in the possession or under the control of the collateral taker ...'

Vos J held that the main objective of the Financial Collateral Regulations was to implement the Directive and that 'the Directive is the dominant piece of legislation and ... is intended to take effect throughout the EU' and, as such, the Regulations should not be construed according to English law principles. The court held that the Regulations should be construed in accordance with EU principles and that on this basis, the court could not accept the argument that as the definition of security interest specifically mentions 'floating charges', an English law floating charge would automatically come within the scope of the exemptions under the Regulations. Instead, the court focused its analysis on the meaning of the words 'in the possession or under the control of the collateral taker' and whether the Declaration of Trust did in fact do this in relation to the monies in the trust account.

It was held that the meaning of 'under the control of' in the context of the Regulations means 'real legal control' and not simply the administrative control (as was exerted by GTP) over the account. Vos J goes on to state that 'real legal control' means that the collateral taker must be able to prevent the collateral provider from using or dissipating the assets during the course of its ordinary business and that this was not the case here in relation to the monies held in the trust account.

The court held that, when applying a true construction of the Regulations, the floating charge created

pursuant to the Declaration of Trust, was not a floating charge within the definition of a security financial collateral arrangement, and as such was not exempt from registration under s. 395 of the 1985 Act. The floating charge created by the Declaration of Trust was held to be void for lack of registration.

In summary, it was held that:

- (i) the charge created by the Declaration of Trust was a floating charge over the monies in the Trust Account in favour of GTP;
- (ii) the floating charge created by the Declaration of Trust did not fall within the definition of a 'security interest' or a 'security financial collective arrangement' under the Financial Collateral Regulations and was therefore not exempt from the registration requirements under the 1985 Act; and
- (iii) the termination fee of GBP 15,000 plus VAT was payable to GTP.

Accordingly, the judge granted the declaration that the Declaration of Trust was void against the liquidators as an unregistered floating charge and ordered that the sums standing to the credit of the Trust Account be paid to the liquidators of F2G.

Significance

This case was the first time the courts have looked at the question of whether a floating charge comes within the registration exemptions of Regulation 4 of the Financial Collateral Regulations. Although this was a first instance decision, it does provide some guidance on when a floating charge may be exempt from registration under the Companies Acts. The court held that the meaning of control for the purpose of a floating charge under the Regulations means 'real legal control' which suggests that an English law floating charge (where typically legal control rests with the chargor) would not come within the Regulations. Following established English authority on fixed and floating charges, such as the Spectrum case, it appears that only an English law fixed charge (as these are charges where the chargee potentially holds legal control over the charged assets) could satisfy the legal control requirement required to come within the scope of the registration exemptions under the Financial Collateral Regulations.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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