

LMA briefing - Q2 2024

Nailing that fixed charge— lessons from Re UKCloudLtd

How to determine whether a charge is fixed or floating has been subject to extensive academic commentary and has exercised the courts for well over a century. While the theoretical difference between the two is now well established, developing market practices and new asset types continue to create challenges when applying the theory in practice.

The level of control a chargee needs to exercise over an asset to ensure it is subject to a fixed charge has been a particular sticking point, and many considered, post *Re Spectrum Plus*¹, that almost complete control must be demonstrated by the chargee. However, last year's decision in *Re Avanti Communications Ltd*², demonstrated that what level of control is necessary is still a somewhat open question. In *Avanti*, the court held that charges over satellite equipment, filings and licences were fixed, despite fairly extensive 'permitted disposal' provisions in the finance documents.

In this briefing, the Lexis+® Banking and Finance team looks at the recent case of *Re UKCloud Ltd* (in liquidation) [2024] EWHC 1259 (Ch). This case, in which the court looked at whether a charge over Internet Protocol (IP) addresses was fixed or floating, follows and builds on the decisions of *Spectrum* and *Avanti*.

While the court in this case decided 'albeit not without misgivings' that the charge was floating, it followed *Avanti* in taking a more nuanced approach to the question of the level of control necessary for a fixed charge. The case is interesting both in terms of the court's approach to determining whether the charge was fixed or floating and its application to (in the context of security case law) a new asset type.

What were the background facts?

The background facts in *Re UKCloud* were as follows. The Company provided cloud computing services to customers, mainly to central government departments and local authorities. The provision of those services involved the use of IP addresses. The terms of use were set out in the RIPE NCC Standard Services Agreement and effectively

gave the Company, in exchange for a fee, the right to use the IP addresses and the right to seek a transfer in certain circumstances. In its judgment, the court explained the nature of the Company's interest in the IP addresses:

The Company here has and had no proprietary interest in the addresses, and its capacity to deal with them was limited: it could sub-allocate them, withdraw them in certain circumstances, reassign them and transfer them; but not simply sell or dispose of them and then replenish the gap created as would be the case with stock or some other asset dealt with as part of the "churn" of business conducted by a shop or similar concern.

The services provided by the Company meant that the Company sub-allocated IP addresses to its customers. There was, however, no formal contract governing the customers' use of the IP addresses.

The Company was wound up by the court in 2022 and the company's assets, including the IP addresses, were realised. The value of the IP addresses to the Company was estimated to be in the region of £700,000. The liquidator and Official Receiver (the OR) of the Company sought directions as to whether the effect of a debenture granted by the Company to Harbert European Speciality Lending Company II SARL (the Lender) gave the Lender the benefit of a fixed or floating charge over the IP addresses.

The Lender's position was that it had a fixed charge. The OR put forward a number of reasons in support of the proposition that the charge was a floating charge.

What is the impact of a charge being floating rather than fixed?

It is worth recapping the impact of a charge being held to be floating rather than fixed. Not only do liquidation and administration expenses, but also amounts owed to preferential creditors and the 'prescribed part'(a percentage set aside for unsecured creditors), take priority over a floating charge holder under insolvency law. Floating charges will often rank behind fixed charges and are also vulnerable to being invalid under s245 Insolvency Act 1986.

The case in point clearly demonstrates the potential implications for a lender. If the charge had been held to be fixed, the proceeds would have gone towards amounts owed

¹ *In re Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680

² *Re Avanti Communications Ltd (in administration)* [2023] EWHC 940

to the Lender, which were in the region of £34 million. As the charge was floating, the proceeds were used to partially defray the expenses of the liquidation. In practice, (as here) the costs of the insolvency process and preferential debts often swallow up any floating charge proceeds leaving nothing for the lender. Lenders will therefore want to obtain fixed charges where they can.

What was the court's approach to determining if the charge was fixed or floating?

The court took the two-stage approach set out in *Agnew v Commissioners of Inland Revenue*³ and followed in subsequent cases, including *Avanti*. This approach involves:

- first construing the charge and determining the nature of the rights and obligations the parties intended to grant each other from the language used, before
- characterising the charge as fixed or floating, given the nature of such rights and obligations.

The intention of the parties is not relevant to the second stage.

This is a reminder of the importance of the provisions set out in the security documents. There has been considerable focus in recent years on practical control, but the first port of call for the courts will be what the parties agreed at the time the security is granted.

How did the court construe the debenture?

The court looked in detail at the charging clause in the debenture.

The court agreed with the Lender's counsel that the IP addresses were caught by a clause in the debenture which purported to create a fixed charge over:

all licences, consents and authorisations (statutory or otherwise) held or required in connection with the Company's business or the use of any Secured Asset, and all rights in connection with them.

In particular, the IP addresses most naturally fell within the meaning of the word 'authorisations'.

There was no specific reference to IP addresses in the charging clause, which, the court commented, could

be taken to be a pointer to the intention of the parties. However, the court considered that the natural and ordinary meaning of the language used in this clause did evince an intention to create a fixed charge.

While the court's interpretation of the clause was reassuring, the comment is a helpful reminder to lenders to specifically refer to and list out any assets over which it wishes to take a fixed charge.

The 'all or nothing' principle

Counsel for the IP put forward a strong argument that, due to the 'all or nothing' principle, the parties can't have intended a fixed charge to be created over the IP addresses. Under the 'all or nothing' principle, all assets caught by a specific charging clause must be either fixed or all must be floating. Courts in previous cases have demonstrated strong tendency to follow this principle (see, for example, *Re Beam Tube Products Ltd*⁴).

Counsel for the IP argued that, in practice, the parties could not have intended all assets potentially caught by the clause creating a charge over '*all licences, consents and authorisations*' to be fixed. The Lender could not have intended to exercise control over the large number of consents and licences which could potentially fall within the clause. The court saw no reason to deviate from the 'all or nothing' principle, and the argument was instrumental in its final decision that the charge was floating.

While the principle is a strange one in some ways, with the possibility of inequitable outcomes, its application here is a key takeaway from the case. It is essential, when drafting fixed charges, that important assets over which control can be demonstrated and a fixed charge taken, are set out in a separate charging clause or sub-clause.

Interestingly, in *Avanti*, the 'all or nothing' principle was not raised as an obstacle to the licences being subject to a fixed charge, despite similar wording.

³ *Agnew v Commissioners of Inland Revenue* [2001] UKPC 28

⁴ *Re Beam Tube Products Ltd* [2006] EWHC 486 (Ch)

How did the court approach the question of the nature of the charge?

The court reiterated the principle that the label used in a debenture to describe the nature of the charge is a guide to the security the parties intended to create but it is not conclusive.

The court therefore proceeded to consider whether the security interest created had the nature of a fixed or floating charge.

The court applied the facts to the three characteristics of a floating charge as set out in the case of *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284.

“I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.”

The nature of the IP addresses and whether they most closely resembled the nature of a fixed or a floating charge asset was discussed at some length. The court concluded that did not ‘fluctuate’ in the sense used in the authorities or form part of the circulating capital of the company as they were not disposed of and replaced. This meant that one key characteristic commonly associated with a floating charge was absent. This, however, was not considered conclusive either way.

In relation to the third criteria, described in the case of *Agnew* as the ‘hallmark of a floating charge’, the court cited the judgment in *Avanti*:

I can see that it is helpful, in considering the question of whether a charge is fixed or floating, to look at the range of possibilities as a spectrum, with total freedom of management at one end of the spectrum, and a total prohibition on dealings of any kind at the other end of the spectrum; see Goode & Gullifer at 4-23. What I cannot see is that a charge will only be fixed if it is located at the total prohibition end of the spectrum. The case law seems to me to support a more nuanced approach, which depends upon a combination of factors.

The judge in *Avanti* considered that the approach in *Spectrum* should be viewed in light of the particular assets charged, and the approach should not necessarily be the same for other kinds of assets.

The judge in *Re UKCloud* considered the approach set out in *Avanti* was the right one to take.

The case therefore suggests the courts are distinguishing the decision in *Spectrum* for different kinds of assets, and favouring a more nuanced approach to the question of control rather than the very strict approach which it was assumed the courts would continue to take post-*Spectrum*.

Was there sufficient control in this case?

In this case, the debenture contained a prohibition on selling, assigning, transferring, parting with possession of or otherwise disposing of in any manner all or any part of, or any interest in, the secured assets without permission. There appear to have been certain exceptions to the prohibition, but, unlike in *Avanti*, these were only briefly referenced, and it isn’t clear what they were.

However, following previous authorities, the judge noted that post-contractual conduct could be relevant when determining whether a charge was fixed or floating. If the controls set out in the documentation are not adhered to in practice, that would indicate that the parties’ intention was, in fact for the charge to be floating.

The court found that, in this case, there was no evidence that the Lender had exercised any control in practice or taken any steps to check that the Company was complying with the terms of the debenture. The charge was therefore held to be floating.

What key takeaways are there from the case when taking security over similar assets?

One question the judge raised was whether IP addresses were, in fact, capable of being subject to a fixed charge, and later he went on to query how and whether control could actually be exercised over such assets in practice. However, he accepted that the decision in *Avanti*, in which permissions and licenses were treated as rights capable of being subject to fixed charge security, gave support to the possibility of a fixed charge over such assets.

The assets in question and how they were used was slightly different in *Avanti*, but even so, this comment, and the decision more generally, raises the question of why the outcomes were different in the two cases.

The key difference appears to be the careful drafting of the controls and permissions in *Avanti* and the parties' adherence to them. In *Avanti*, the borrower was specifically permitted to create sub-licences, whereas in *Re UKCloud*, the borrower allowed customers exclusive use of the IP addresses with no formal agreement with its customers or (it seems) formal permission whether upfront or on each occasion from the Lender.

Re UKCloud therefore acts as a good reminder when taking security to:

1. identify at an early stage the assets likely to have value, including less obvious intangible assets
2. ensure the assets are listed and charged separately (rather than assuming they will be caught within a 'bucket' clause)
3. consider how best to demonstrate the intention to create a fixed charge over the relevant assets, focusing on how control may be demonstrated over each kind of asset – this may require careful thought for less tried and tested asset types, and
4. ensure that there is a paper trail demonstrating that such provisions are being complied with in practice