

RE AVANTI COMMUNICATIONS LIMITED (IN ADMINISTRATION) – CHARACTERISATION OF SECURITY AS FIXED/FLOATING

The recent English case of *Re Avanti Communications Limited (in administration)*¹ is a helpful first instance case for secured lending and will also be welcomed by borrowers and lenders in Hong Kong. It consolidates the English law on the characterisation of security as fixed/floating and clarifies that the existence of disposal permissions in respect of a secured asset will not automatically undermine fixed security over it. The judgment provides a useful consolidation of the applicable English law principles (on what are often complex issues) for Hong Kong market participants. In this briefing note, we consider the key points from the case and what it means for security going forward.

BACKGROUND

Avanti's business was the operation of satellites and the sale of satellite broadband and satellite connectivity services. Under two debentures, Avanti granted fixed charges over a satellite payload and its related tangible and intangible infrastructure (including certain satellite network filings and ground station licences) and a floating charge over any assets not subject to a fixed charge. The security was collateral for several debt documents, in particular a super senior facilities agreement which contained the most restrictive obligations (the "**SSF**"). One of these restrictions was on asset disposals, subject to specified exceptions, as is typical of such debt documents.

The case was brought by the joint administrators of Avanti to determine whether certain assets sold in a pre-pack were subject to a fixed or floating charge. The consequence of that characterisation would determine if HM Revenue & Customs ("**HMRC**") was entitled to any administration proceeds as a preferential creditor. From 1 December 2020, HMRC ranks, under English insolvency law, as a preferential creditor in respect of certain taxes due from an insolvent business, a return to the priority it previously enjoyed before 2003. If the security was floating, HMRC would be accorded its preferential status. HMRC did not itself participate in the proceedings, but the arguments

Key points

- Characterisation involves a two-stage test
- Fixed security does not require absolute control over the secured asset
- Disposal permissions in respect of the secured asset will not automatically compromise fixed security – it is a question of degree
- Case law calls for a nuanced approach to characterisation, taking into account a combination of factors
- The nature of the assets is a key factor: the ability to deal with fluctuating assets is likely to indicate a floating charge, whereas some ability to deal with specific, non-fluctuating assets can be consistent with a fixed charge
- From a Hong Kong perspective, this judgment offers a useful consolidation of numerous English law principles in this area

¹ [2023] EWHC 940 (Ch) (25 April 2023)

in favour of a floating charge were identified by the administrators who took a neutral stance in the case.

The case involved the construction of the later of the two debentures (the earlier debenture was on materially the same terms) and the SSF to determine whether the security was floating rather than fixed. The Judge reached the conclusion that the security was fixed.

TWO STAGE TEST

The Judge confirmed the two-stage enquiry set out in *Agnew v Commissioners of Inland Revenue*² (see text box). This is a useful starting point and framework for the analysis of whether security is fixed or floating.

The Judge then embarked on a detailed examination of the law in this area as set out in various textbooks and cases, most notably the 2005 *Spectrum Plus* case³. The judgment includes colour on the difference between fixed and floating charges, the characteristics of a floating charge (see text box) and how to approach the two-stage test, providing a useful consolidation of the law.

NOT ALL OR NOTHING

The Judge did not accept the suggestion in some academic commentary that a charge could only be fixed if there was a total prohibition on any dealings with the secured assets. He did not consider that the case law supported such an absolute view.

While it might be helpful to look at the range of a chargor's ability to deal with secured assets as a spectrum, with total freedom of management at one end of the spectrum and a total prohibition of any dealings of any kind at the other, a charge will not be fixed only if it is located at the total prohibition end of the spectrum. Rather, the case law supports a more nuanced approach to characterisation, requiring a number of factors to be taken into account, with a key factor being the nature of the assets (see below).

Debt documents do often contain permissions as to disposal of assets, so this is a useful confirmation that such provisions will not automatically undermine fixed security. In the case, the SSF set out a series of exceptions to the general prohibition on asset sales or disposals, but these exceptions were tightly circumscribed and critically did not extend to disposing of the secured assets in the ordinary course of business or trading, which would have pointed towards a floating charge. In applying the "first stage" test, the Judge found that while certain disposals of assets were permitted by the SSF, in reality the ability of Avanti to deal with the secured assets was strictly limited. Further, as a matter of fact, there was no history of the restrictions not being observed.

NATURE OF THE ASSETS IS A KEY FACTOR

The case confirms that, when considering the "second stage" test, the nature of the assets is a key factor in the analysis and endorses the distinction drawn in prior cases between: (i) assets which are part of a company's circulating capital or stock in trade; and (ii) assets which are specific and not necessarily fluctuating.

Two-stage test

- Firstly, construe the security document and ascertain the nature of the rights and obligations the parties intended to grant from the language of the document
- Secondly, categorise the security, which is a matter of law not depending on the intention of the parties

Fixed / Floating charges

- Per Lord Scott in *Spectrum Plus*: the hallmark of a floating charge is that the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime, the chargor is left free to use the charged asset and remove it from the security.
- Per Lord Walker in *Spectrum Plus*: under a fixed charge, the assets charged as security are permanently appropriated to the payment of the sum charged, in such a way as to give the chargee a proprietary interest in the assets. So long as the charge remains unredeemed, the assets can be released from the charge only with the active concurrence of the chargee.

² [2001] UKPC 28 [2001] 2 AC 710

³ *National Westminster Bank plc v Spectrum Plus Ltd & Ors* [2005] UKHL 41

Assets in the former category are more likely to be subject to a floating charge as the company typically needs to deal with them as part of its day-to-day business. Assets in the latter category are therefore more amenable to fixed security. It is then a question of the degree of control over them. Some ability of the company to deal with such assets is not necessarily inconsistent with a fixed charge; however, if that ability is extensive, the charge is likely to be floating as there is in effect no attachment of the charge to any specific asset.

The Judge emphasised that the secured assets were not circulating capital or fluctuating assets or circulating stock in trade. They were income generating assets and did not need to be sold to generate the income. The distinction was relevant which was drawn in prior cases between: (i) an income generating asset; and (ii) income generated by that asset. Where the asset has intrinsic value separate from the income generated, as was the case with the secured assets, control of the income is not required for a fixed charge. Such separation does not apply in the case of, for example, debts and their proceeds.

WHAT DOES THIS MEAN FOR SECURITY?

The case is helpful as a matter of English law, as well as in Hong Kong, in providing a comprehensive statement of the law in this area, with a detailed review of previous case law, as well as a clear judicial response to some academic commentary which suggested the law imposed a more stringent test for characterising security as fixed rather than floating.

The case also reminds parties of the importance that the court will place on well drafted security documents, and in particular when seeking to take fixed security, the need to ensure that the nature and extent of any restrictions are clearly articulated and adhered to.

The colour provided by the case may also be instructive in other contexts, for example when analysing security over financial collateral in terms of whether there is the requisite control for a security financial collateral arrangement for the purpose of the UK Financial Collateral Arrangements Regulations.

Borrowers and lenders will be reassured that fixed security does not require absolute control over the secured assets and the clarification that characterisation is a nuanced and fact-specific exercise. Understandably the Judge declined to identify the point on the spectrum of control where a floating charge gives way to a fixed charge and vice versa, which may point to a more conservative approach to control when taking a fixed charge in order to mitigate recharacterisation risk. Key points for any analysis will be whether the assets are circulating capital or fluctuating assets, whether the chargor can freely deal with them in the ordinary course of business (which may be more likely in the case of book debts, or cash collateral) and whether any dealing by the chargor is over income only or over the charged asset itself.

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