

United Kingdom: *Re Avanti Communications Limited (in administration)* — a critical examination of fixed and floating charges

In brief

In *Avanti Communications Ltd [2023] EWHC 940 (Ch)*, the English court revisited the vexed issue of fixed and floating charges. Notably, it is the first significant case since the landmark decision in *Re Spectrum Plus Ltd [2005] UKHL 41* to do so.

The distinction between fixed and floating charges is economically important and affects the recoveries a secured creditor may expect to receive in an insolvent liquidation of the security provider.

The High Court found that a satellite (together with its related infrastructure, permits and licences) was subject to a fixed charge at the time of its disposal. In doing so, the High Court clarified that a total prohibition on a security provider's ability to deal with charged assets and their proceeds is not necessary for a charge to be categorised as a fixed charge. Categorisation of a charge is two-stage process; firstly, ascertaining the parties' rights and obligations in respect of a secured asset and, secondly, deciding as a matter of law what type of charge has been created based on the rights and obligations provided.

Given the nature of the charged assets, none of the general permissions for the security provider to deal with assets were practically available to it. In addition, the parties agreed that, upon disposal of the charged assets, any disposal proceeds were required to be applied in repayment of the secured debt (with a 1% "make whole" premium). The assets themselves were the "tangible and non-tangible infrastructure" of Avanti Communication's business (rather than "fluctuating assets"), and consequently the relevant charge was correctly categorised as fixed.

This decision will come as welcome news to secured creditors and demonstrates the English courts' willingness to take a practical and commercial approach to the construction of finance documents.

In this issue

[Key takeaways](#)[In depth](#)

Key takeaways

- A court will carefully examine any ability to dispose or deal with charged assets and their proceeds, but a complete prohibition on dealing is not necessarily required to establish a fixed charge.
- Factors likely to be taken into account by a court when categorising a charge over a particular asset as fixed or floating include the following:
 - Whether the asset is of a type that is sold to generate income ("circulating capital or fluctuating assets or circulating stock in trade") or whether it is used in the business to assist with income generation
 - The extent to which particular or general permissions to deal with assets are of practical relevance to dealings with the asset in question
 - Whether the disposal proceeds may be retained by the security provider or paid over to the secured creditor (and, if so, whether there are commercially unattractive terms for doing so)
 - Any history of dealings with the asset (or assets of the same type) with or without consent
- Where commercially appropriate, parties should consider the following:

- **Labelling as fixed charge:** Expressly label a charge as "fixed" (if this is the intention). This is relevant evidence of the parties' intentions for the first stage of the categorisation process (discussed in detail below), although not determinative.
- **Limited contractual permissions:** Contractual permissions to deal with assets without consent should be limited to those assets of a type that are part of the "circulating capital or fluctuating assets or circulating stock in trade" of the relevant business.
- **Clearly define categories of assets:** Where there is an asset category that includes some particularly valuable or important assets and others that are less important, or some assets that are typically sold or disposed of to generate income and some that are not, consider separating the security taken over those assets into two categories in the security document. This will mitigate the risk of dealings with the less important assets resulting in the categorisation of the charge over all such assets being floating.
- **Licences:** Where operating licences or leases are important to the business (e.g., in this case, the Ofcom licences), ensure that any disposal permission referring to licences or leases applies to a disposal of assets by way of licence or lease rather than a disposal of a licence or lease that is an asset required by the business in its operations.
- **Control of proceeds:** Require any disposal proceeds to be paid over to the secured creditor rather than the security provider being free to retain and use those proceeds as it wishes.
- **Post-contractual conduct:** Ensure that any request to dispose of an asset (where consent is required) is dealt with individually and on its merits and the consent properly documented. Whilst conduct subsequent to the creation of a charge is usually not relevant to the categorisation of a charge as fixed or floating, if there is evidence of subsequent dealings that are inconsistent with the nature of a charge as fixed, a court may consider that the labelling in the security document is not determinative and re-characterise the charge as floating.

In depth

Avanti Communications concerned the disposal of certain tangible assets (including a satellite and network and ground station facilities) and intangible assets (including licences required by Ofcom (the UK's communications regulator) and network filings (required to use orbital slots) to operate).

The case was brought by the joint administrators (who adopted a neutral position) and a number of senior creditors, including HPS Investment Partners LLC and Solus Alternative Asset Management LP (who argued that all such assets were subject to a fixed charge). These assets were expressed to be subject to separate fixed charges under certain all-asset security documents.

In *Spectrum Plus*, the House of Lords considered whether a security document that was expressed to create a "specific charge" over book debts and other debts created a fixed or floating charge as a matter of English law. It set a high bar for the creation of a fixed charge by requiring the relevant security document to grant the secured creditor contractual rights to exercise control over the relevant asset and for it to exercise control in practice.

The distinction between fixed and floating charges is economically important when a security provider enters insolvency. Aside from proper costs and expenses incurred in relation to the preservation and enforcement of the fixed charge assets, the entire proceeds of realisation are paid over to the fixed charge-holder. In contrast, a number of other categories of debts, including expenses of the insolvency, moratorium debts and preferential debts, rank ahead of debts secured by a floating charge, and a portion of the proceeds of enforcement of a floating charge must be shared with unsecured creditors.

In *Avanti Communications*, Johnson J followed a two-stage process to decide whether the charges over the satellite and other relevant assets were fixed or floating.

- **Stage one** involves construing the security document to ascertain the nature of the rights and obligations that the parties intended to grant each other in respect of the charged assets.

At stage one, the use of a fixed or floating label can be used as one indicator of what the parties objectively intended.

In *Avanti Communications*, the security documents:

- Were expressed to create security "by way of first fixed charge" over "Equipment" and "Licences". The court was clear that the relevant assets fell within these definitions.

- Were expressed to create a floating charge over only those assets not effectively subject to a fixed charge so there was a clear intention to only create a floating charge over assets that were not "Equipment" or "Licences" (or any of the other categories of assets over which fixed security was intended to be created).
- Provided that assets were only to be released from the security, among other things, if not prohibited by the terms of the facilities agreements and provided that a legal opinion and a directors' certificate confirming the disposal is permitted are provided.

Also of relevance are any **contractual permissions** (so-called "Permitted Disposal" baskets) to dispose or deal with assets, the **nature of the assets** in question (whether part of the business' "circulating" or "non-circulating" capital), the **nature of the business** of the security provider and the **treatment of disposal proceeds** (whether they may be freely retained by the security provider or must be paid over to the secured creditor).

Contractual permissions: The "Permitted Disposal" baskets in the *Avanti Communications* secured debt documents included the following:

- The **limited value exception** (disposals of assets of less than USD 2 million)
- The **capacity exception** (deal-specific exception to dispose of satellite capacity in the ordinary course of business)
- The **obsolete exception** (disposals of worn out or obsolete assets)
- The **usefulness exception** (disposals of assets no longer useful in the business)
- The **licence exception** (licences in the ordinary course of business)

Johnson J analysed each of these categories and concluded that none was relevant to the specific assets for the following reasons:

- The assets were of too high value.
- The ability to dispose of assets in the ordinary course of business should be considered a reference to make sales, lettings and transfers of "circulating assets" rather than assets required to conduct business.
- Intangible assets (such as the licences and filings) cannot be "obsolete" (to be obsolete, an asset must be damaged or worn out and so must, necessarily, be of limited value)
- The licence exception should be construed as an ability to dispose of assets by way of licences rather than an ability to dispose of licences

Treatment of proceeds: To the extent no "Permitted Disposal" basket was applicable, the security provider was not permitted to freely use any disposal proceeds and was required to apply the net proceeds (above USD 1 million) in prepayment of the secured debt, together with a 1% "make whole" prepayment premium.

Nature of assets/business: Beyond the contractual restrictions, the assets in question were not Avanti's "circulating capital" or "fluctuating assets" (and so more susceptible to being subject to a floating charge) but, based on the nature of its business, its "tangible and non-tangible infrastructure".

Johnson J noted that these rights and obligations demonstrated the parties' intention to create a fixed charge over the relevant assets and included considerable restrictions on their disposal.

- **Stage two** is a matter of law and involves the court categorising the charge based on those rights and obligations. The label given to the charge by the parties is not relevant at this stage. The critical question is whether the rights and obligations ascertained at stage one demonstrate that the security provider or the secured creditor has control of the relevant asset.

The degree of control required can be considered on a sliding scale from total freedom for the security provider to a complete prohibition on any dealings by the security provider.

Based on the rights and obligations established at stage one, whilst there was no total prohibition on dealing with the relevant assets, *Avanti Communications* was "materially and significantly" limited from doing so and the freedoms provided by the "Permitted Disposal" baskets were not applicable in the present circumstances. With no "Permitted Disposal" baskets to rely on, *Avanti Communications* was not free to retain the disposal proceeds and the existence of the "make whole" premium on prepayment of the facilities made any disposal commercially unattractive.

The court concluded that all the relevant assets were held to be subject to a fixed charge.

- **Points to note:**

- This case did not involve any party arguing that the charges should be construed as floating charges. The administrators that brought the case adopted a neutral stance and the senior creditors that joined the proceedings had a clear interest in the charges being held to be fixed charges. It is possible that other arguments would have been introduced had a junior creditor, arguing that the charges should be construed as floating, been party to the proceedings.
- The secured debt document referred to by Johnson J in his judgment is of a type commonly known as a "Term Loan B" (or TLB). A common feature of loans of this type are the generally extensive permissions to deal with assets without requiring further consent from the secured creditors. TLB creditors will welcome the increased clarity provided by the English courts in construing such permissions to deal with a charged asset by focussing on their application to the nature of the specific assets being disposed of (e.g., "infrastructure" versus "circulating assets").
- Another common feature of English law TLBs is that the "Permitted Disposal" baskets are often included in a schedule and expressed to be construed in accordance with New York law rather than English law, which governs the facility agreement generally. In this case, with the parties' agreement, Johnson J construed the provisions on a "plain reading" as if the principles of construction of English law and New York law were the same. Whilst he was of the view that "particular principles of construction whether under English law or New York law (if in any way different) [do not] have any great part to play" in his conclusions, it should be borne in mind that certain terms may be construed differently under those respective laws. In particular, the phrase "in the ordinary course of business" has a different meaning under English law than New York law, and this may impact the permissiveness of a particular "Permitted Disposal" basket.
- Different types of facility agreement impose different regimes for handling asset disposal proceeds. These range from the security provider being free to retain some or all proceeds (and perhaps being required to use those proceeds for particular purposes) to the security provider being required to prepay the facilities, either at par or with a prepayment fee, premium or "make whole" sum. Having concluded that none of the "Permitted Disposal" baskets where the security provider would have been entitled to retain the disposal proceeds was relevant in this case, Johnson J placed a degree of weight on the commercial unattractiveness of being required to use disposal proceeds to make a prepayment with a 1% prepayment fee. Any ability for a security provider to retain disposal proceeds and/or to make a prepayment at par may increase the likelihood of a charge being characterised as floating; although, the nature of the relevant assets may well be more important to the end result.
- No reference was made in the judgment to *Re ASRS Establishment Ltd* [2000] 1 BCLC 727. That case concerned the characterisation of a charge over "all book debts, bank account credit balances and other debts and claims" and, in particular, sums held in an escrow account. The security document prohibited the security provider from dealing with book debts other than in the ordinary course of its business and required it to pay any collections into a designated account. In practice, the secured creditor never required this to be done. It was held that, since the security provider was free to deal with its book debts, the entirety of the charge over "all book debts, bank account credit balances and other debts and claims" was to be characterised as floating, even those sums held in the blocked escrow account. It is interesting that no reference was made in *Avanti Communications* to other assets falling within the definition of "Equipment" or "Licences" that may have been dealt with by the company or for which certain "Permitted Disposal" baskets could be relevant. *Re ASRS Establishment Ltd* would suggest that, in such circumstances, the entirety of the charge over "Equipment" could be categorised as floating with no ability to conclude it was fixed in respect of the relevant assets in question and floating in respect of other assets in the same category. It would be sensible to create separate categories of "Equipment" and "Licences" over which security is taken so that any dealings with less important assets in these categories do not run the risk of tainting the fixed nature of the charge over the more important assets.

No further action needed

No specific action on your end is required. We will keep you informed of future developments. Please reach out to one of the listed contacts if you have further queries on this matter.

Contact Us



Matthew Cox

Partner
London

matthew.cox@bakermckenzie.com



Norman Womuhai

Trainee Solicitor
London

norman.womuhai@bakermckenzie.com



Gabby White

Knowledge Lawyer
London

gabby.white@bakermckenzie.com

© 2023 Baker & McKenzie. **Ownership:** This site (Site) is a proprietary resource owned exclusively by Baker McKenzie (meaning Baker & McKenzie International and its member firms, including Baker & McKenzie LLP). Use of this site does not of itself create a contractual relationship, nor any attorney/client relationship, between Baker McKenzie and any person. **Non-reliance and exclusion:** All information on this Site is of general comment and for informational purposes only and may not reflect the most current legal and regulatory developments. All summaries of the laws, regulation and practice are subject to change. The information on this Site is not offered as legal or any other advice on any particular matter, whether it be legal, procedural or otherwise. It is not intended to be a substitute for reference to (and compliance with) the detailed provisions of applicable laws, rules, regulations or forms. Legal advice should always be sought before taking any action or refraining from taking any action based on any information provided in this Site. Baker McKenzie, the editors and the contributing authors do not guarantee the accuracy of the contents and expressly disclaim any and all liability to any person in respect of the consequences of anything done or permitted to be done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this Site. **Attorney Advertising:** This Site may qualify as "Attorney Advertising" requiring notice in some jurisdictions. To the extent that this Site may qualify as Attorney Advertising, PRIOR RESULTS DO NOT GUARANTEE A SIMILAR OUTCOME. All rights reserved. The content of the this Site is protected under international copyright conventions. Reproduction of the content of this Site without express written authorization is strictly prohibited.

