HOUSE OF LORDS SESSION 2005–06
[2005] UKHL 41

on appeal from: [2004] EWCA Civ 670

OPINIONS

OF THE LORDS OF APPEAL

FOR JUDGMENT IN THE CAUSE

National Westminster Bank plc (Respondents)
v.
Spectrum Plus Limited and others and others (Appellants)

Appellate Committee

Lord Nicholls of Birkenhead
Lord Steyn
Lord Hope of Craighead
Lord Scott of Foscote
Lord Walker of Gestingthorpe
Baroness Hale of Richmond
Lord Brown of Eaton-under-Heywood

Counsel

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LORD NICHOLLS OF BIRKENHEAD

My Lords,

1. I have had the advantage of reading in draft the opinions of my noble and learned friends Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give I agree that the decision of Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 was wrong and should be overruled.

2. The respondent bank had a second string to its bow. The bank contended that if the House considered *Siebe Gorman* was wrongly decided the House should overrule that decision only for the future. The bank submitted that the *Siebe Gorman* decision should continue to apply to all transactions entered into before your Lordships' decision in the present case, including the debenture under consideration on this appeal.

3. This submission raises a controversial issue of major importance concerning the power of your Lordships' House to give a ruling in this 'prospective only' form. The bank argued the House has this power. The Crown appellants were content to assume the House may have this power. At very short notice the Attorney General, on the invitation of your Lordships, appointed Mr Glick QC to assist the House by presenting the case against the House having any such jurisdiction. The House is indebted to Mr Glick, who was assisted by Mr Edmund Nourse, for his clear and comprehensive presentation of this case.

Prospective overruling

4. The starting point is to note some basic, indeed elementary, features of this country's judicial system. The first concerns the essential role of courts of law. In the ordinary course the function of a court is adjudicative. Courts decide the legal consequences of past happenings. Courts make findings on disputed questions of fact, identify and apply the relevant law to the facts agreed by the parties or found by the court, and award appropriate remedies.

5. The second feature concerns the wider effect of a court decision on a point of law. To promote a desirable degree of consistency and certainty about the present state of 'the law', courts in this country have long adopted the practice of treating decisions on a point of law as precedents for the future. If the same point of law arises in another case at a later date a court will treat a previous decision as binding or persuasive, depending upon the well-known hierarchical principles of 'stare decisis'.

6. The third feature is that from time to time court decisions on points of law represent a change in what until then the law in question was generally thought to be. This happens most obviously when a court departs from, or an appellate court overrules, a previous decision on the same point of law. The point of law may concern the interpretation of a statute or it may relate to a principle of 'judge-made' law, that is, the common law (which for this purpose includes equity). A change of this nature does not always involve departing from or overruling a previous court decision. Sometimes a court may give a statute, until then free from judicial interpretation, a different meaning from that commonly held.

7. The fourth feature is a consequence of the second and third features. A court ruling which changes the law from what it was previously thought to be operates retrospectively as well as prospectively. The ruling will have a retrospective effect so far as the parties to the particular dispute are concerned, as occurred with the manufacturer of the ginger beer in *Donoghue v Stevenson* [1932] AC 562. When Mr Stevenson manufactured and bottled and sold his ginger beer the law on manufacturers' liability as generally understood may have been as stated by the majority of the Second Division of the Court of Session and the minority of their Lordships in that case. But in the claim Ms Donoghue brought against Mr Stevenson his legal obligations

fell to be decided in accordance with Lord Atkin's famous statements. Further, because of the doctrine of precedent the same would be true of everyone else whose case thereafter came before a court. Their rights and obligations would be decided according to the law as enunciated by the majority of the House of Lords in that case even though the relevant events occurred before that decision was given.

8. People generally conduct their affairs on the basis of what they understand the law to be. This 'retrospective' effect of a change in the law of this nature can have disruptive and seemingly unfair consequences. 'Prospective overruling', sometimes described as 'non-retroactive overruling', is a judicial tool fashioned to mitigate these adverse consequences. It is a shorthand description for court rulings on points of law which, to greater or lesser extent, are designed not to have the normal retrospective effect of judicial decisions.

9. Prospective overruling takes several different forms. In its simplest form prospective overruling involves a court giving a ruling of the character sought by the bank in the present case. Overruling of this simple or 'pure' type has the effect that the court ruling has an exclusively prospective effect. The ruling applies only to transactions or happenings occurring after the date of the court decision. All transactions entered into, or events occurring, before that date continue to be governed by the law as it was conceived to be before the court gave its ruling.

10. Other forms of prospective overruling are more limited and 'selective' in their departure from the normal effect of court decisions. The ruling in its operation may be prospective and, additionally, retrospective in its effect as between the parties to the case in which the ruling is given. Or the ruling may be prospective and, additionally, retrospective as between the parties in the case in which the ruling was given and also as between the parties in any other cases already pending before the courts. There are other variations on the same theme.

11. Recently Advocate General Jacobs suggested an even more radical form of prospective overruling. He suggested that the retrospective *and prospective* effect of a ruling of the European Court of Justice might be subject to a temporal limitation that the ruling should not take effect until a future date, namely, when the State had had a reasonable opportunity to introduce new legislation: *Banco Popolare di*

Cremona v Agenzia Entrate Ufffficio Cremona (Case C-475/03, 17 March 2005), paras 72-88.

United Kingdom practice

12. Prospective overruling has not yet been adopted as a practice in this country. The traditional approach was stated crisply by Lord Reid in *West Midland Baptist (Trust) Association Inc v Birmingham Corporation* [1970] AC 874, 898-899, a case concerning compulsory acquisition:

> 'We cannot say that the law was one thing yesterday but is to be something different tomorrow. If we decide that [the existing rule] is wrong we must decide that it always has been wrong, and that would mean that in many completed transactions owners have received too little compensation. But that often happens when an existing decision is reversed.'

13. In *Launchbury v Morgans* [1973] AC 127, 137, Lord Wilberforce noted 'We cannot, without yet further innovation, change the law prospectively only'. More recently, in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 379, Lord Goff of Chieveley said the system of prospective overruling 'has no place in our legal system'.

14. The possibility of a change in this practice has been raised from time to time. In *R v National Insurance Commissioner, Ex p Hudson* [1972] AC 944, 1015, 1026, Lord Diplock said this topic deserved consideration. Lord Simon of Glaisdale said the possibility of prospective overruling should be seriously considered. He expressed a preference for legislation, saying that 'informed professional opinion' was probably to the effect that the House had no power to overrule decisions with prospective effect only. Lord Simon repeated his plea in *Milliangos v George Frank (Textiles) Ltd* [1976] AC 443, 490. In the Court of Appeal in *R v Governor of Brockhill Prison, Ex p Evans (No 2)* [1999] QB 1043, 1058, Lord Woolf MR expressed the view that prospective overruling has much to commend it. In your Lordships' House this issue was left open: [2001] 2 AC 19. Lord Slynn of Hadley, with his Luxembourg experience in mind, considered there may be situations in which it would be desirable, and in no way unjust, that the effect of judicial rulings should be prospective or limited to certain

claimants: page 26. Lord Hobhouse of Woodborough was hostile to prospective overruling, describing it as a denial of the constitutional role of the courts: page 48. In the advocates' immunity case of *Arthur J S Hall & Co v Simons* [2002] 1 AC 615 the House departed from the earlier decision of the House in *Rondel v Worsley* [1969] 1 AC 191. The decision on the immunity point in the *Hall* case did not affect the actual outcome in that case. In that context my noble and learned friend Lord Hope of Craighead expressed the view that the change in the law made by the *Hall* decision should take effect only from the date of the judgment in that case: page 726. He said, at page 710:

> 'I consider it to be a legitimate exercise of your Lordships' judicial function to declare prospectively whether or not the immunity – which is a judge-made rule – is to be available in the future and, if so, in what circumstances.'

15. Perhaps the nearest the House has come to giving non-retroactive rulings was in two decisions on the law of undue influence. The decisions concerned cases where, typically, a wife claims her consent to a mortgage of her share in a jointly-owned home was procured by her husband exercising undue influence over her: *Barclays Bank Plc v O'Brien* [1994] 1 AC 180 and *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773. In both cases the House said that, in order to avoid being fixed with constructive notice of the wife's rights, a bank could reasonably be expected to bring home to the wife the risks she was running. But in both cases the House sought to give guidance by being more specific on what that test meant in practice. It was in this limited respect that in both cases the House, having regard to realities, drew a distinction between past and future transactions. In the *O'Brien* case, at pages 196-197, Lord Browne-Wilkinson said that whether the steps taken by the creditor satisfied the prescribed test would, for past transactions, depend on the facts of each case. As to the future, an appropriately worded warning given at a private meeting between the creditor and the wife would generally suffice to satisfy the test. Despite this admonition the banks did not adopt the course of holding such a meeting. In the *Etridge* case the House decided that holding a private meeting was not the only way a bank could discharge its obligation to bring home to the wife the risks she was running. I set out, at pages 811-812, paras 79-80, other steps which would generally be regarded as discharging this obligation as to future transactions and, separately, as to past transactions.

16. These two decisions illustrate the flexibility inherent in this country's legal system. In passing, another instance of this flexibility can be noted. This illustrates how the House has been prepared to depart from a strict and narrow interpretation of the judiciary's adjudicative role. From time to time situations occur where a point of law of general importance is raised by court proceedings but the outcome will have no practical effect in the particular case. The general principle is that the court will not entertain such proceedings. Nevertheless, when there is good reason for doing so, the House, in the cautious exercise of its discretion, may proceed to decide the point of law. A recent example occurred in the Judicial Committee of the Privy Council in *Attorney General for Jersey v Holley* [2005] UKPC 23. There an enlarged Board resolved a conflict between previous decisions of the Board and the House of Lords on an important issue concerning the defence of provocation to a charge of murder. The Board decided this point even though the outcome, either way, would have no effect on the conviction or sentence of the defendant in that case.

17. One further matter may be noted regarding the present position on prospective overruling. In the devolution legislation of 1998 Parliament made express provision for courts to have power to limit the temporal effect of a particular class of decisions. The Scotland Act 1998, section 102, provides that where a court decides a provision in an Act of the Scottish Parliament is not within the legislative competence of the Parliament the court may make an order removing or limiting any retrospective effect of the decision or suspending the effect of the decision to enable the defect to be corrected. Comparable provisions appear in the Government of Wales Act 1998, section 110, and the Northern Ireland Act 1998, section 81. These provisions show that Parliament does not perceive non-retroactive rulings by courts as being of their nature inconsistent with the judiciary's proper function.

Overseas experience

18. In other common law countries prospective overruling has taken root as such only in the United States of America and India. In the United States the fortunes of prospective overruling, sometimes known colloquially as 'Sunbursting', have waxed and waned. Prospective overruling, although without that label, occurred as long ago as the mid-19th century in the Ohio case of *Bingham v Miller* (1848) 17 Ohio 45. In 1932 the Supreme Court, in a famous judgment of Justice Cardozo, held that the Constitution neither prohibits nor requires prospective overruling. The Federal Court, he said, 'has no voice upon the subject':

see *Great Northern Railway Co v Sunburst Oil & Refining Co* 287 US 358. Prospective overruling by the Supreme Court itself reached its apogee in the 1960s and 1970s when the court decided that in both criminal and civil cases 'the accepted rule today is that in appropriate cases the Court may in the interests of justice make the rule prospective': *Linkletter v Walker* (1965) 381 US 618, 628. In 1971 in the leading case of *Chevron Oil Co v Huson* (1971) 404 US 97, 106-107, the court summarised three factors taken into account when considering if a decision should be applied non-retroactively: whether the decision established a new principle of law, whether retrospective operation would advance or retard the operation of the new rule, and whether the decision could produce substantial inequitable results if applied retrospectively.

19. Since then the Supreme Court has retreated. In *Griffith v Kentucky* (1987) 107 S Ct 708 the court abandoned prospective overruling when directly reviewing criminal cases. Selective overruling has been abandoned in civil cases: *James B Beam Distilling Co v Georgia* (1991) 501 US 529 and *Harper v Virginia Department of Taxation* (1992) 509 US 86. Whether the court has abandoned 'pure' prospective overruling in civil cases remains to be resolved: see *Glazner v Glazner* (2003) 347 F 3d 1212, a decision of the Court of Appeals of the Eleventh Circuit.

20. Taking its lead from the United States jurisprudence the Supreme Court of India has made prospective overrulings but only in constitutional cases. The first case was *Golak Nath v State of Punjab* (1967) 2 SCJ 762. In that case the court reversed two earlier decisions of its own in circumstances where meanwhile constitutional amendments had been made, and state laws enacted, on the basis of the court's earlier two decisions. The jurisdiction is not confined to cases where an earlier decision is overruled. Non-retroactive effect may be given to a ruling which decides an issue for the first time: *India Cement Ltd v State of Tamil Nadu* (1990) 1 SCC 12. The Supreme Court founds its jurisdiction to make rulings of this character on article 142 of the Indian Constitution. This article empowers the Supreme Court to 'make such order as is necessary for doing complete justice in any cause or matter pending before it'. In exercise of this power it is a 'well settled proposition that it is open to the Court to grant, mould or restrict relief in a manner most appropriate to the situation before it, in such a way as to advance the interests of justice': *Orissa Cement Ltd v State of Orissa* 1991 Supp (1) SCC 430.

21. In Ireland in *Murphy v Attorney General* [1982] IR 241 the Supreme Court held that certain taxation provisions were unconstitutional and void. The court rejected an argument that it was for the courts to say whether these statutory provisions should be held to be invalid prospectively or with only limited retrospective effect. The provisions were invalid from the date on which they were enacted. However, the court also held that the plaintiffs' restitutionary right to recover amounts paid by way of taxes unconstitutionally imposed began with the first year in which they raised their objections. Further, unless other taxpayers had already made tax recovery claims, only the plaintiffs could maintain a claim pursuant to the court's decision.

22. In Canada prospective overruling has not found favour. In *Re Edward and Edward* (1987) 39 DLR (4th) 654 the Saskatchewan Court of Appeal said prospective overruling would be a 'dramatic deviation from the norm in both Canada and England'. Bayda CJS, at page 664, said 'the most cogent reason for rejecting this technique is the necessity for our courts to maintain their independent, neutral and non-legislative role'. He approved comments that prospective overruling 'would distort our expectations of the judicial role' and that 'confidence may recede at the point where the courts are not seen as adjudicative agencies but as legislators': see Lord Lloyd of Hampstead, 'Introduction to Jurisprudence', 4th ed, (1979), pp 858-859. But in the extreme circumstances of a *Reference re Language Rights under the Manitoba Act 1870* (1985) 19 DLR (4th) 1 the Supreme Court of Canada declined to give retroactive effect to its decision on the constitutional invalidity of all statutes and regulations of the Province of Manitoba not printed and published in both English and French. A declaration that the unilingual laws of Manitoba were of no effect would have created a legal vacuum with consequent legal chaos. Refusing to take a narrow and literal approach to constitutional interpretation, the court held it could have regard to unwritten postulates such as the principle of the rule of law. Faced with the task of recognising the unconstitutionality of Manitoba's unilingual laws while avoiding a legal vacuum and ensuring the continuity of the rule of law, the court made a ruling which gave deemed temporary validity to all laws rendered invalid by reason of their unilingual defect.

Luxembourg and Strasbourg

23. Far-reaching economic consequences may flow from the retrospective effect of rulings by the European Court of Justice on the interpretation of Community instruments. This has led that court to

limit the temporal effect of some of its rulings, from *Defrenne v Sabena* [1976] ECR 455 onwards. Sitting as a Grand Chamber the court recently reiterated its basic approach in *R (Bidar) v Ealing London Borough Council* [2005] 2 WLR 1078, 1112, para 66:

> 'the interpretation the Court of Justice gives to a rule of Community law is limited to clarifying and defining the meaning and scope of that rule *as it ought to have been understood and applied from the time of its coming into force*. It follows that the rule as thus interpreted may, and must, be applied by the courts even to legal relationships arising and established before the judgment ruling on the request for interpretation ..' (emphasis added)

But the court noted that 'exceptionally' it may limit the temporal effect of a ruling. It has done so only in defined circumstances (paragraph 69):

> 'The court has taken that step only in quite specific circumstances, where there was a risk of serious economic repercussions owing in particular to the large number of legal relationships entered into in good faith on the basis of rules considered to be validly in force and where it appeared that both individuals and national authorities had been led into adopting practices which did not comply with Community legislation by reason of objective, significant uncertainty regarding the implications of Community provisions, to which the conduct of other member states or the Commission may even have contributed ...'

24. Unlike the European Court of Justice and its role in the interpretation of Community instruments, the European Court of Human Rights' interpretative function is not confined to identifying the meaning properly to be given to the European Convention on Human Rights when it first came into force. The Strasbourg court interprets the Convention in the light of present-day conditions: *Marckx v Belgium* (1979) 2 EHRR 330, 353, para 58. In that case, taking heed of the decision of the European Court of Justice in *Defrenne v Sabena* [1976] ECR 455, the Strasbourg court held that the principle of legal certainty dispensed the Belgian state from re-opening legal acts antedating the delivery of its judgment.

25. A notable instance of this 'dynamic and evolutive' approach to interpretation can be found in the successive cases relating to recognition of the rights of transsexual persons, culminating in the decision in *Goodwin v United Kingdom* (2002) 35 EHRR 447. In *Goodwin* the court held that the United Kingdom could 'no longer claim' that the matter fell within its margin of appreciation and that the fair balance inherent in the Convention 'now' tilted in favour of the applicant: para 93. Running through the court's reasoning is an acceptance that the earlier, contrary decisions of the court remained correct statements of the interpretation and application of the Convention when they were given. Consistently with this the court held that the finding of violation 'with the consequences which will ensue for the future' was just satisfaction: para 120.

Practical difficulties

26. As with all controversial subjects prospective overruling attracts arguments both ways. The arguments against prospective overruling are both principled and practical. It will be convenient to note first the major practical difficulties attendant upon prospective overruling. The retrospective nature of a court ruling on a point of law means that the ruling applies in all cases, past as well as future. This is subject only to defences of general application, such as limitation, laches, and res judicata. Whatever its faults the retrospective application of court rulings is straightforward. Prospective overruling creates problems of discrimination. Born out of a laudable wish to mitigate the seeming unfairness of a retrospective change in the law, prospective overruling can beget unfairness of its own.

27. This is most marked in criminal cases, where 'pure' prospective overruling would leave a successful defendant languishing in prison. 'Selective' prospective overruling avoids this consequence but it could see a successful defendant freed while others in like case stayed in prison. In civil cases 'pure' prospective overruling would hinder the development of the law by discouraging claimants from challenging a prevailing view of the law. 'Selective' overruling, if only the successful claimant benefits from the change, is likely to mean that persons in like case are treated differently. Further, it would introduce an arbitrary element into the law. The ability to obtain an effective remedy could depend upon which of several challenges reaches the House of Lords first. Even if everyone who had already commenced proceedings was given the benefit of the court ruling there would still be scope for discrimination: there would be discrimination between those who knew

they might have a claim and started proceeding post-haste and those, lacking proper advice, who were unaware they might have a claim.

Objections in principle

28. The essence of the principled argument against prospective overruling is that in this country prospective overruling is outside the constitutional limits of the judicial function. It would amount to the judicial usurpation of the legislative function. Power to make rulings having only prospective effect, it is said, is not inherent in the judicial role. A ruling having only prospective effect cannot be characterised as merely a less extensive form of overruling than overruling with both retrospective and prospective effect. Prospective overruling robs a ruling of its essential authenticity as a judicial act. Courts exist to decide the legal consequences of past events. A court decision which takes the form of a 'pure' prospective overruling does not decide the dispute between the parties according to what the court declares is the present state of the law. With a ruling of this character the court gives a binding ruling on a point of law but then does not apply the law as thus declared to the parties to the dispute before the court. The effect of a prospective overruling of this character is that, on the disputed point of law, the court determines the rights and wrongs of the parties in accordance with an answer which it declares is no longer a correct statement of the law. Making such a ruling would not be a proper exercise of judicial power in this country. Making new law in this fashion gives a judge too much the appearance of a legislator. Legislation is a matter for Parliament, not judges.

29. In short, this argument raises this issue: would a decision by this House on a point of law having only prospective effect be so substantial a departure from established judicial procedure that it should be regarded as outside the function discharged by the judiciary under this country's constitution?

30. In answering this question the Appellate Jurisdiction Act 1876 (39 & 40 Vict, c 59) provides no assistance. The appellate jurisdiction of the House is formally regulated by this Act. Section 4 provides that appeals shall be brought by petition to the House praying that the order appealed may be reviewed 'before Her Majesty the Queen in her Court of Parliament' in order that this court 'may determine what of right, and according to the law and custom of this realm, ought to be done in the subject-matter of such appeal'. When Part III of the Constitutional

Reform Act 2005 comes into force the new Supreme Court will have power 'to determine any question necessary to be determined for the purposes of doing justice in an appeal to it': section 40(5). These general statements do not point either way on the issue now under consideration.

31. The next point to note is that, broadly stated, the constitutional separation of power between the legislature and the judiciary in this country is that the legislature makes the law, the courts administer the law. Parliament makes new law, by enacting statutes having prospective and varying degrees of retrospective effect: see *Wilson v First County Trust Ltd (No 2)* [2004] 1 AC 816, 831-832, para 19. When disputes arise, whether between citizens or between a citizen and the government, they are to be resolved in accordance with the law, and that is a matter for the judicial arm of the state. In this regard it is for the judiciary to decide what is the law, not the legislature or the executive.

32. This broad generalisation is a good starting point but, like most constitutional generalisations in this country, it calls for qualification. The boundary between making and administering the law is not in all respects quite so clear-cut as this general statement suggests. Contrary to the broad generalisation and within strict bounds, judges themselves have a legitimate law-making function. It is a function they have long exercised. In common law countries much of the basic law is still the common law. The common law is judge-made law. For centuries judges have been charged with the responsibility of keeping this law abreast of current social conditions and expectations. That is still the position. Continuing but limited development of the common law in this fashion is an integral part of the constitutional function of the judiciary. Had the judges not discharged this responsibility the common law would be the same now as it was in the reign of King Henry II. It is because of this that 'the common law is a living system of law, reacting to new events and new ideas, and so capable of providing the citizens of this country with a system of practical justice relevant to the times in which they live': see Lord Goff of Chieveley in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 377.

33. Changes in the common law made by judges are usually described as 'development' of the common law. This is a helpful description, not a misleading euphemism. Judges do not have a free hand to change the common law. Judicial development of the common law comprises the reasoned application of established common law principles, of greater or less generality, in current social conditions.

Development of the common law by the judges in any one case is usually marginal. Occasionally it is more far-reaching, as in *Donoghue v Stevenson* [1932] AC 562. In all cases development of the common law, as a response to changed conditions, does not come like a bolt out of a clear sky. Invariably the clouds gather first, often from different quarters, indicating with increasing obviousness what is coming. Justice Cardozo's colourful summary, in his 'The Nature of the Judicial Process' (1921), p 141, merits repetition:

> 'The judge, even when he is free, is still not wholly free. He is not to innovate at pleasure. He is not a knight-errant, roaming at will in pursuit of his own ideal of beauty or of goodness. He is to draw his inspiration from consecrated principles. He is not to yield to spasmodic sentiment, to vague and unregulated benevolence. He is to exercise a discretion informed by tradition, methodized by analogy, disciplined by system, and subordinated to "the primordial necessity of order in the social life"'.

34. At one time the judicial function of overruling previous common law decisions was sought to be rationalised by the 'declaratory' theory. Sir William Blackstone said that 'if it be found that the former decision is manifestly absurd or unjust, it is declared not that such a sentence was *bad law*, but that it was *not law*': 'Commentaries on the Laws of England' 1st ed, (1765), vol 1, p 70. If 'law' is given one of its several possible meanings, this theory is still valid when applied to cases where a previous decision is overruled as wrong when given. Most overruling occurs on this basis. These cases are to be contrasted with those where the later decision represents a response to changes in social conditions and expectations. Then, on any view, the declaratory approach is inapt. In this context this approach has long been discarded. It is at odds with reality.

35. For present purposes the distinction between these two types of cases is not important. Nor is the declaratory theory. For present purposes what matters is the practical impact overruling may have in both types of cases. The question now under consideration is whether, having regard to this practical impact, it is necessarily and always beyond the competence of the House as the supreme court in this country ever to limit the temporal effect of its ruling.

36. Before answering this question I must mention the judicial role in respect of statute law. Under section 4 of the Human Rights Act 1998 the court has an evaluative role in respect of primary legislation when considering whether to make a declaration of incompatibility. That apart, the essential function of the courts in respect of statutes is to apply and give effect to them. In cases of dispute the courts decide what, properly understood ('interpreted'), the legislation means. From time to time cases arise where changed social conditions dictate that a statutory provision should have a different and wider meaning than when enacted. *Fitzpatrick v Sterling Housing Association Ltd* [2001] 1 AC 27 is an instance of this. The House decided that by 1994 the long term homosexual partner of a Rent Act tenant was 'a member of the original tenant's family' even though that phrase would not have been so interpreted when the statutory provisions were first enacted in 1920. Such cases, arising out of changed circumstances, are exceptional.

37. There is another way courts can find themselves obliged to give a 'dynamic' interpretation to statutes. Section 3 of the Human Rights Act 1998 requires courts to read and give effect to legislation in a way which is compatible with Convention rights so far as it is possible to do so. When interpreting Convention rights courts must take into account decisions of the European Court of Human Rights: section 2(1). As already noted, that court gives an evolving interpretation to the principles embedded in the European Convention on Human Rights. Thus, indirectly, through changes in the interpretation and application of Convention rights, the courts of this country may find it necessary to give legislation a changed meaning.

38. Cases of these types are of increasing importance. But leaving these aside, the interpretation the court gives an Act of Parliament is the meaning which, in legal concept, the statute has borne from the very day it went onto the statute book. So, it is said, when your Lordships' House rules that a previous decision on the interpretation of a statutory provision was wrong, there is no question of the House changing the law. The House is doing no more than correct an error of interpretation. Thus, there should be no question of the House overruling the previous decision with prospective effect only. If the House were to take that course it would be sanctioning the continuing misapplication of the statute so far as existing transactions or past events are concerned. The House, it is said, has no power to do this. Statutes express the intention of Parliament. The courts must give effect to that intention from the date the legislation came into force. The House, acting in its judicial capacity, must give effect to the statute and it must do so in accordance with what it considers is the proper interpretation of the statute. The

House has no suspensive power in this regard. In *Ha v State of New South Wales* (1997) 189 CLR 465, 503-504, 515, the High Court of Australia unanimously considered 'it would be a perversion of judicial power to maintain in force that which is acknowledged not to be the law'. This would especially be so where 'non-compliance with a properly impugned statute exposes a person to criminal prosecution'.

Conclusion

39. The objections in principle and difficulties in practice mentioned above have substance, particularly in respect of the traditional interpretation of statutes. These objections are compelling pointers to what should be the normal reach of the judicial process. But, even in respect of statute law, they do not lead to the conclusion that prospective overruling can never be justified as a proper exercise of judicial power. In this country the established practice of judicial precedent derives from the common law. Constitutionally the judges have power to modify this practice.

40. Instances where this power has been used in courts elsewhere suggest there could be circumstances in this country where prospective overruling would be necessary to serve the underlying objective of the courts of this country: to administer justice fairly and in accordance with the law. There could be cases where a decision on an issue of law, whether common law or statute law, was unavoidable but the decision would have such gravely unfair and disruptive consequences for past transactions or happenings that this House would be compelled to depart from the normal principles relating to the retrospective and prospective effect of court decisions.

41. If, altogether exceptionally, the House as the country's supreme court were to follow this course I would not regard it as trespassing outside the functions properly to be discharged by the judiciary under this country's constitution. Rigidity in the operation of a legal system is a sign of weakness, not strength. It deprives a legal system of necessary elasticity. Far from achieving a constitutionally exemplary result, it can produce a legal system unable to function effectively in changing times. 'Never say never' is a wise judicial precept, in the interest of all citizens of the country.

42. Moreover, in one particular context the courts' ability to give a ruling having only prospective effect seems irresistible. As noted above, at times the Strasbourg court interprets and applies the European Convention on Human Rights with prospective effect only. It would be odd if in interpreting and applying Convention rights the House was not able to give rulings having a comparable limited temporal effect: see Lord Rodger of Earlsferry, 'A Time for Everything under the Law: Some Reflections on Retrospectivity', (2005) 121 LQR 57, 77.

43. I turn to the present case. In my view it is miles away from the exceptional category in which alone prospective overruling would be legitimate. No doubt over the years the clearing banks, including the respondent bank, have to some extent relied upon the *Siebe Gorman* decision when formulating and using their standard forms of charges on book debts. But banks and others who lend money on the security of charges on a company's undertaking are sophisticated operators. There is no reason to suppose this decision lulled them into a false sense of security. *Siebe Gorman* was a first instance decision. It cannot have been regarded as definitively settling the law in this field. Moreover, if the firm and unanimous decision now being given by the House were given prospective effect only, the result would be that in many existing liquidations preferential creditors would be deprived of the priority Parliament intended they should have. I would reject the bank's submission that this decision of the House should have only prospective effect. I would allow this appeal accordingly.

LORD STEYN

My Lords,

44. I have had the advantage of reading the opinions of my noble and learned friends, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. I am in full agreement with their opinions.

45. In regard to prospective overruling I see the good sense of not saying "never" as explained by my noble and learned friend Lord Nicholls of Birkenhead. On the other hand, like Lord Scott, at present I find it difficult to see how it could be possible to permit prospective overruling in a dispute about the interpretation of a statute.

46. I would also make the order which Lord Scott proposes.

LORD HOPE OF CRAIGHEAD

My Lords,

47. As so often happens when a company goes into creditors' voluntary liquidation, the assets which are available to pay Spectrum's general creditors are insufficient to pay those creditors in full after payment of the preferential debts of the company. Section 175(2)(b) of the Insolvency Act 1986, re-enacting a rule that was first introduced over 100 years ago by the Preferential Payments in Bankruptcy Amendment Act 1897, (60 & 61 Vict, c 19), provides that, so far as the assets of the company available for payment of general creditors are insufficient to meet them, preferential debts have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the company, and that they shall be paid accordingly out of any property comprised in or subject to that charge. It is notorious that this state of affairs operates to the disadvantage of creditors whose claims are secured by a charge which takes the form of a floating charge and not that of a fixed security. From the creditor's point of view, it deprives the floating charge of much of its utility.

48. Section 251 of the 1986 Act provides that the expression "floating charge" means "a charge which, as created, was a floating charge and includes a floating charge within the meaning of section 462 of the Companies Act (Scottish floating charges)." Section 462(1) of the Companies Act 1985, which makes provision for the creation of floating charges in Scotland, states:

> "It is competent under the law of Scotland for an incorporated company…, for the purpose of securing any debt or other obligation (including a cautionary obligation) incurred or to be incurred by, or binding upon, the company or any other person, to create in favour of the creditor in the debt or obligation a charge, in this Part referred to as a floating charge, over all or any part of the property (including uncalled capital) which may from time to time be comprised in its property and undertaking."

That provision must be read together with section 463(1)(b) of the 1985 Act, which declares that where a Scottish company goes into liquidation within the meaning of section 247(2) of the Insolvency Act 1986 a floating charge created by the company attaches to the property then comprised in the company's property and undertaking or, as the case may be, in part of that property and undertaking, but does so subject to the rights of any person who holds a fixed security over the property or any part of it ranking in priority to the floating charge. It must also be read together with section 464(6) the 1985 Act as amended by section 439(1) of and Schedule 13 to the 1986 Act, which states that the order of ranking set out in that section is subject to sections 175 and 176 of the 1986 Act as to the ranking of preferential debts in winding up. So the rule that was first introduced by the 1897 Act for England and Wales applies to Scottish floating charges too.

49. Prior to 1961 it was impossible for a Scottish company to create a floating charge over the whole or any part of its property and undertaking. In *In re Bank of Credit and Commerce International S A (No 8)* [1998] AC 214, 226 Lord Hoffmann, speaking of English law, said that a charge is a security interest created without any transfer of title or possession to the beneficiary. But a charge could not be created without any transfer of title or possession in Scotland. In *Carse v Coppen*, 1951 SC 233, it was conceded that a company registered in Scotland could not create a valid and effectual floating charge over its assets in Scotland, but it was contended that it had done so over its assets in England. This argument was rejected. Lord President Cooper said at p 239 that a floating charge was utterly repugnant to the principles of Scots law, which did not recognise it as creating a security at all. At p 241 he referred to that fact that the reforms in the law which had been effected because of the many criticisms that had been directed against the injustices capable of being inflicted on the trade creditors by the use of floating charges had been expressly confined to companies registered in England. He said that it was unthinkable that this could have been done except upon the view that companies registered in Scotland and subject to Scots law could not create floating charges.

50. This situation was thought to be to the disadvantage of Scottish companies. So the law of Scotland was amended by the Companies (Floating Charges) (Scotland) Act 1961, later extended by the Companies (Floating Charges and Receivers) Act 1972, to enable Scottish companies to give security in this way. The result, in the words of Professor W A Wilson, *"Floating Charges"*, 1961 SLT (News) 53, was that there was now in the law of Scotland a completely new form of security which could be effectively granted over corporeal moveables

without relinquishing possession, over incorporable moveables without giving intimation and over heritage without recording a deed in the Sasine Register. It was, if I may respectfully borrow this phrase from the speech of my noble and learned friend Lord Walker of Gestingthorpe, a cuckoo in the nest of Scots property law – as your Lordships were to discover in the case of *Sharp v Thomson*, 1997 SC (HL) 66, which revealed some of the problems caused by introducing this form of charge into a legal system to which it did not belong naturally.

51. It is, of course, possible under the statutory regime that now applies in Scotland – it is currently to be found in Part XVIII of the 1985 Act – for a company to create a floating charge over its book debts. Indeed, a creditor seeking to secure his debt by means of a floating charge will usually wish to see to it that the property over which the charge extends includes the book debts of the company. But subjecting book debts to a security which will be effective as a fixed charge in Scots law, and will thus escape from the priority which section 175 of the 1986 Act gives to preferential debts, is far less convenient in practice. This is because the law of Scotland still insists that a fixed charge can be created only by delivery of the property which is to be subjected to it into the hands of the creditor or by the equivalent of delivery. The only way in which this can be done in the case of book debts is by obtaining an assignation in security of the right to receive payment of the debt, which is then intimated to the party who is liable to pay the debt to the company. A company which wishes to continue to trade is unlikely to find this method of creating a charge over its book debts acceptable: *Fletcher and Roxburgh*, *The Law and Practice of Receivership in Scotland*, 3rd ed (2005), para 2.10. In practice, therefore, a creditor who wishes to obtain a security from a Scottish company over its book debts will only be able to do this by way of a floating charge.

52. The creation of a charge over book debts which will be effective in English law as a fixed charge does not present the same difficulties. As Slade J said in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, 158, the decision of the House of Lords in *Tailby v Official Receiver* (1888) 13 App Cas 523 showed that it is competent for anyone to whom book debts may accrue in the future to create for good consideration an equitable charge upon those book debts which will attach to them as soon as they come into existence. But if this is to be effective as a fixed security everything depends on the way the security agreement ensures that the charge over the book debts is fixed. It is not easy to reconcile the company's need to continue to collect and

use these sums for its own business purposes with the lender's wish to escape from the priority which section 175(2)(b) gives to preferential debts over the claims of the holder of a floating charge by subjecting the uncollected book debts to a security which will operate as a fixed charge over them.

Did Spectrum's debenture create a fixed charge?

53. My noble and learned friend, Lord Scott of Foscote has described the facts of the case and summarised all the relevant authorities. I adopt with gratitude all that he has said about them, and I agree with him that the charge which the company granted by way of what the debenture described as a specific charge over its book debts and other debts then and from time to time owing to the company was in law a floating charge. It was not a fixed charge, so section 175(2)(b) applies to it. The preferential creditors have priority over the bank's claims under the debenture to the sums realisable from the book debts and other debts of the company.

54. There are, as Professor Sarah Worthington has pointed out, a limited number of ways to ensure that a charge over book debts is fixed: *An 'Unsatisfactory Area of the Law' – Fixed and Floating Charges Yet Again*, (2004) 1 International Corporate Rescue, 175, 182. One is to prevent all dealings with the book debts so that they are preserved for the benefit of the chargee's security. This is the only method which is known to Scots law which, as I have said, insists upon assignation of the book debts to the security holder and its intimation to the company's debtor as the equivalent of their delivery. One can, of course, be confident where this method is used that the book debts will be permanently appropriated to the security which is given to the chargee. But a company that wishes to continue to trade will usually find the commercial consequences of such an arrangement unacceptable. Another is to prevent all dealings with the book debts other than their collection, and to require the proceeds when collected to be paid to the chargee in reduction of the chargor's outstanding debt. But this method too is likely to be unacceptable to a company which wishes to carry on its business as normally as possible by maintaining its cash flow and its working capital. A third is to prevent all dealings with the debts other than their collection, and to require the collected proceeds to be paid into an account with the chargee bank. That account must then be blocked so as to preserve the proceeds for the benefit of the chargee's security. A fourth is to prevent all dealings with the debts other than their collection and to require the collected proceeds to be paid into a

separate account with a third party bank. The chargee then takes a fixed charge over that account so as to preserve the sums paid into it for the benefit of its security.

55. The method that was selected in this case comes closest to the third of these. It was selected, no doubt, because it enabled the company to continue to trade as normally as possible while restricting it, at the same time, to some degree as to what it could do with the book debts. The critical question is whether the restrictions that it imposed went far enough. There is no doubt that their effect was to prevent the company from entering into transactions with any third party in relation to the book debts prior to their collection. The uncollected book debts were to be held exclusively for the benefit of the bank. But everything then depended on the nature of the account with the bank into which the proceeds were to paid under the arrangement described in clause 5 of the debenture. As McCarthy J said in *In re Keenan Bros* Ltd [1986] BCLC 242, 247, one must look, not at the declared intention of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention. Was the account one which allowed the company to continue to use the proceeds of the book debts as a source of its cash flow or was it one which, on the contrary, preserved the proceeds intact for the benefit of the bank's security? Was it, putting the point shortly, a blocked account?

56. I do not see how this question can be answered without examining the contractual relationship in regard to that account between the bank and its customer. An account from which the customer is entitled to withdraw funds whenever it wishes within the agreed limits of any overdraft is not a blocked account. In *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710, 722, para 22 Lord Millett said that the critical feature which led the Irish Supreme Court in *In re Keenan Bros Ltd* [1986] BCLC 242 to characterise the charge on book debts as a fixed charge was that their proceeds were to be segregated in a blocked account where they would be frozen and unusable by the company without the bank's written consent. I respectfully agree. Elsewhere in his judgment he appears to have assumed that the account into which the proceeds of the book debts were to be paid under the debenture in the *Siebe Gorman* case [1979] 2 Lloyd's Rep 142 was also a blocked account: p 727, para 38; p 730, para 48. In para 38 he said that the company could collect the money but was not free to use it as it saw fit. The question whether he was right when he made that assumption is at the heart of this case.

57. For the reasons which have been explained much more fully by Lord Scott and Lord Walker, I too would hold that it is impossible to conclude that the debenture in the *Siebe Gorman* case had that effect. As I read the critical passage in Slade J's judgment at pp158-159, he appears to have reached that conclusion in two stages. First, he said, the effect of the debenture was to create a specific charge on the proceeds of the debts as soon as they were received which prevented the company from disposing of an unencumbered title to them without the mortgagor's consent. Second, he said that the bank would have had the right, if it chose, to assert its lien under the charge on the proceeds of the book debts, even at a time when the account into which they were paid was temporarily in credit.

58. As to the first point, I would agree that the effect of clause 5(c) of the debenture (the equivalent of clause 5 in our case) was that the company was prevented from doing anything with the proceeds of the book debts when collected other than paying them into its account with the bank. But it seems to me that second point – that the bank could assert a lien over the proceeds – overlooks the fact that the account into which the proceeds were to be paid was the company's current account with the bank which the company was to continue to be free to operate for its own business purposes within the agreed limit of its overdraft.

59. As May LJ said in *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340, 1353, the money which a customer deposits with a bank becomes the bank's money, but the bank is prima facie bound to meet its debt when called upon to do so by the customer. In *Westminster Bank Ltd v Hilton* (1926) 43 TLR 124, 126 Lord Atkinson explained the relationship in this way:

> "It is well established that the normal relation between a banker and his customer is that of debtor and creditor, but it is equally well established that *quoad* the drawing and payment of the customer's cheques as against money of the customer's in the banker's hands the relation is that of principal and agent. The cheque is an order of the principal's addressed to the agent to pay out of the principal's money in the agent's hands the amount of the cheque to the payee thereof."

The general rule is that a banker is bound to honour his customer's cheque so long as he has funds in his hands if the account is in credit, or

up to the agreed limit of any overdraft. He may determine the contract at any time on giving notice to the customer. But he cannot refuse to honour cheques drawn before the notice of determination is received.

60. A banker has a general lien over all bills, notes and negotiable instruments belonging to the customer which his customer may have deposited with him in security of the customer's indebtedness to the bank. But a lien is a right to retain possession of property that belongs to someone else, and the banker has no lien over funds which, when deposited in its account by the customer, become his own property. Moreover the relationship is one where, if the account is in credit, the banker is indebted to his customer. So it was a misuse of the word lien to say that the bank could assert a right of that kind over the proceeds: see Buckley LJ in the Court of Appeal in *Halesowen Presswork and Assemblies Ltd v Westminster Bank Ltd* [1971] 1 QB 1, 46, and Viscount Dilhorne and Lord Cross of Chelsea in the same case in the House of Lords [1972] AC 785; Lord Hoffmann in *In re Bank of Credit and Commerce International S A (No 8)* [1998] AC 214, 226. This is not to say that it is impossible to conceive of the creation of an equitable charge over the proceeds of book debts paid into an account in the name the chargor. But the ordinary relationship of banker and customer does not permit the banker, without notice, to refuse to allow his customer to operate a current account as and whenever he wishes while it is credit or is within the limits of any agreed overdraft. The debenture in the *Siebe Gorman* case, which provided for the payment of the proceeds into an account of that kind, lacked any provision which qualified that relationship.

61. In the Court of Appeal Lord Phillips of Worth Matravers MR [2004] Ch 337, 383, para 94 said that, in the determination of the question whether the charge over the book debts was fixed, the extent of the customer's contractual right to draw out sums equivalent to the amounts paid in must be disregarded. But the relationship between a bank and its customer is founded in contract. The company's undertaking in clause 5 of the debenture to pay the proceeds of the book debts into its account with the bank has to be seen and understood in that context. This was a current account into which the company paid money drawn from a variety of other sources as well as the proceeds of its book debts. In my opinion the company's continuing contractual right to draw out sums equivalent to the amounts paid in is wholly destructive of the argument that there was a fixed charge over the uncollected proceeds because the account into which the proceeds were to be paid was blocked.

Should Siebe Gorman be overruled?

62. Lord Phillips of Worth Matravers MR said that, even if Slade J's construction of the debenture in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 had appeared to him to be erroneous, he would have been inclined to hold that the form of the debenture had, by custom and usage, acquired the meaning and effect that he had attributed to it: [2004] Ch 337, 383, para 97. This was because the form had been used for 25 years under the understanding that this was its meaning and effect. Banks had relied upon this understanding, and individuals had guaranteed the liabilities of companies to banks on the understanding that the banks would be entitled to look first to their charges on book debts unaffected by the claims of preferred creditors. The respondents say that this is the course that ought now to be followed in the interests of commercial certainty.

63. The House's Practice Statement of 26 July 1966 reminds us that the use of precedent is an indispensable foundation on which to decide what is the law and how it should be applied in individual cases: *Practice Statement (Judicial Precedent)* [1966] 1 WLR 1234. It promotes the degree of certainty that is needed for the guidance of those who must regulate their affairs according to the law. It is hard to think of an area of the law where the need for certainty is more important than that with which your Lordships are concerned in this case. The commercial life of this country depends to a large extent on the reliability of the security arrangements that are entered into between debtors and their creditors. The law provides the context in which these arrangements are entered into, and it lays down the rules that have to be applied when the arrangements break down. Mistakes as to the law can make all the difference between success and failure when the creditor seeks to realise his security. So a heavy responsibility lies on judges to provide the lending market with guidance that is accurate and reliable. This is so that mistakes can be avoided and transactions entered into with confidence that they will achieve what is expected of them.

64. These are powerful considerations, but I am in no doubt that the proper course is for the *Siebe Gorman* decision to be overruled. It is a tribute to the great respect which Slade LJ's outstandingly careful judgments, both at first instance and the Court of Appeal, have always commanded that his decision in that case has remained unchallenged for so many years. But the fact is that it was a decision that was taken at first instance, and it has now been conclusively demonstrated that the construction which he placed on the debenture was wrong. This is not

one of those cases where there are respectable arguments either way. With regret, the conclusion has to be that it is not possible to defend the decision on any rational basis. It is not enough to say that it has stood for more than 25 years. The fact is that, like any other first instance decision, it was always open to correction if the country's highest appellate court was persuaded that there was something wrong with it. Those who relied upon it must be taken to have been aware of this. It provided guidance, and no criticism can reasonably be levelled at those who felt that it was proper to rely on it. But it was no more immune from review by the ultimate appellate court than any other decision which has been taken at first instance.

Should Siebe Gorman be overruled prospectively?

65. Changes in the law do not occur in a vacuum. Much is likely to depend on whether the change affects situations before the change occurs or whether it affects only situations that come afterwards. On the whole legislation affects the future only and not the past, although awareness of what is to come may well influence the way people conduct their affairs before its commencement. The reverse is true of judicial decisions.

66. In *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70, 95, my noble and learned friend Lord Nicholls of Birkenhead said that prospective overruling was not yet a principle known in English law. Certainly it is as true today as it was then that it has not yet been adopted as a practice in this country: see para 12 of his speech in this case. But in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 378-379, Lord Goff of Chieveley declared that it had no place in our legal system. He said:

> "Subject to consideration by appellate tribunals, and (within limits) by judges of equal jurisdiction, what [a judge] states to be the law will, generally speaking, be applicable not only to the case before him but, as part of the common law, to other comparable cases which come before the courts, whenever the events which are the subject of those cases in fact occurred.
>
> It is in this context that we have to reinterpret the declaratory theory of judicial decision…. when the judges state what the law is, their decisions do, in the sense I have described, have a retrospective effect. That is, I believe,

> inevitable. It is inevitable in relation to the particular case before the court, in which the events must have occurred some time, perhaps some years, before the judge's decision is made. But is also inevitable in relation to other cases in which the law as so stated will in future fall to be applied. I must confess that I cannot imagine how a common law system, or indeed any legal system, can operate otherwise if the law is to be applied equally to all and yet be capable of organic change."

Later in the same paragraph he said that a system of prospective overruling, although it had occasionally been adopted elsewhere, had no place in our legal system.

67. In *Ha and another v State of New South Wales* (1997) 189 CLR 465, 503-504 the High Court of Australia was just as firm in its rejection of the invitation that it should, if it came to the conclusion that the tobacco wholesalers' and retailers' licence fees were invalid, overrule the franchise cases prospectively, leaving the authority of those cases unaffected for a period of 12 months:

> "This Court has no power to overrule cases prospectively. A hallmark of the judicial process has long been the making of binding decisions of rights and obligations arising from the operation of the law upon past events or conduct. The adjudication of existing rights and obligations as distinct from the creation of rights and obligations distinguishes the judicial power from non-judicial power. Prospective overruling is thus inconsistent with judicial power on the simple ground that the new regime that would be ushered in when the overruling took effect would alter existing rights and obligations. If an earlier case is erroneous and it is necessary to overrule it, it would be a perversion of judicial power to maintain in force that which is acknowledged not to be the law."

68. I do not think that these declarations can be taken as the last word on this issue, at least so far as the powers of your Lordships' House are concerned. The ability of courts to make prospective rulings, if they have power to do so, can no longer be said to be in question. Section 102 of the Scotland Act 1998 provides that, where a court declares that any provision in an Act of the Scottish Parliament is not within the

competence of the Parliament, it may make an order removing or limiting the effect the decision. Equivalent provisions are to be found in section 110 of the Government of Wales Act 1998 and section 88(1) of the Northern Ireland Act 1998. This power is a limited one, as it is available only where legislation is held to be invalid because it is outside the devolved institution's legislative competence. But it is nevertheless significant. The European Court of Justice has acknowledged that the interpretation it gives to a rule of Community law is limited to clarifying and defining the meaning and scope of that rule as it ought to have been understood and applied from the time of its coming into force: *R (Bidar) v Ealing London Borough Council*, Case C-209/03, [2005] 2 WLR 1078, 1112, para 66. But, as the court said in the same case, it has in exceptional cases limited the temporal effect of its judgments, having regard to the principle of legal certainty, where it is satisfied that those concerned acted in good faith on the basis of the rules considered to be validly in force and that for it not to do so would give rise to serious economic difficulties: paras 67-69; see also the opinion of Advocate General Jacobs in *Banco Populare di Cremona v Agenzia Entrate Ufficio Cremona*, Case C-475/03, para 75. This power has been developed by judicial decision notwithstanding the fact that there is no express treaty base in articles 230-231 EC for its exercise.

69. The fact that the Judicial Committee of the Privy Council has been given this power in devolution cases by statute and that a similar power has been developed by the European Court of Justice does not, of course, answer the question whether the House has the power, in exceptional cases, to do likewise. But it is for the House, as the ultimate court, to define the limits of its own jurisdiction. It can take as its starting point the inherent power which it has under the common law to do whatever is necessary to serve the interests of justice. That power is, of course, subject as our constitution requires to the doctrine of Parliamentary sovereignty. It must respect any limits on its jurisdiction that have may been imposed by Parliament, so long as these are compatible with our treaty obligations under Community law and with the rights that are defined by section 1(1) of the Human Rights Act 1998 as the Convention rights. A statutory limitation which was found to be incompatible would have to be read down under the doctrine of direct effect or under section 3(1) of the 1998 Act to remove the incompatibility. Subject to these exceptions, its jurisdiction is limited only by the fact that the inherent power which is vested in the House in its appellate capacity is a judicial power, not a legislative one.

70. Authority for this approach, if it is needed, is to be found in *R v Bow Street Metropolitan Stipendiary Magistrate (No 2), Ex p Pinochet*

Ugarte [2000] 1 AC 119 in which, in the exercise of its power as the ultimate court of appeal to correct any injustice caused by one of its own orders, the House set aside the decision which it had reached in the first appeal, [2000] 1 AC 61. The respondents did not dispute that the House had jurisdiction in appropriate cases to rescind or vary one of its earlier orders. But Lord Browne-Wilkinson, who delivered the leading speech, went further. At p 132D-E he said that in his judgment that concession was rightly made both in principle and on authority:

> "In principle it must be that your Lordships, as the ultimate court of appeal, have power to correct any injustice caused by an earlier order of this House. There is no relevant statutory limitation on the jurisdiction of the House in this regard and therefore its inherent jurisdiction remains unfettered. In *Broom v Cassell & Co Ltd (No 2)* [1972] AC 1136 your Lordships varied an order for costs already made by the House in circumstances where the parties had not had a fair opportunity to address argument on the point."

The circumstances in that case were, of course, quite different. But the principle which the House was applying there is capable of a much wider application.

71. The question then is whether it can ever be consistent with the exercise of its judicial power for the House to declare that a decision which it takes which changes the law is not to affect events or things done in the past but only events or things done in the future. While I recognise the force of Lord Goff's argument to the contrary in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, I think that it would be unwise to say that the power to do this can never be available in any circumstances. The speeches that were delivered in *R v Governor of Brockhill Prison, Ex p Evans (No 2)* [2001] 2 AC 19 show how reluctant your Lordships have been to engage in this debate. It is no doubt true that in almost every case that can be imagined the exercise of the judicial power will require the House simply to declare what the law is, with the inevitable result that it will apply to other comparable cases whenever the events occurred. But it is not possible to predict the future with complete confidence, and it seems to me that the question whether this technique should be adopted remains an open one. Richard H S Tur, "Time and Law" (2002) Oxford Journal of Legal Studies, 463, 473, has observed that to apply an admittedly new rule retrospectively is blatantly legislative however fair or otherwise normatively appealing

this may be. At p 474 he said that commentators can agree that prospective overruling has, in Lord Goff's words, "no place in our legal system" but disagree as to whether it should have a place, adding that it might be that in exceptional circumstances, where justice was served thereby, the effect of a judicial decision could expressly be declared to be prospective only. I do not think that we can say that there will never be cases when the interests of justice may require the removal of the retrospective effect of a judgment by making a declaration to that effect.

72. The question whether such a declaration will ever be consistent with the exercise of judicial power must, in the end, depend on the issue that the House is being called upon to decide. In *Arthur J S Hall & Co v Simons* [2002] 1 AC 615, 726H, for example, I said that I was of opinion that the decision in that case which changed the law about the immunity from suit of the advocate should take effect only from the date when the House delivered its judgment. That was a highly unusual case. In the Court of Appeal it was held that the solicitors had not acted as their clients' advocate and their conduct was not so intimately connected with the conduct of the case in court as to attract the immunity. I said at the outset of my speech that the grounds which the Court of Appeal had given for its decision were entirely sound, sufficient and satisfactory and that it was unnecessary for the disposal of the appeal to examine the fundamental question whether the core forensic immunity which the House had recognised in *Rondel v Worsley* [1969] 1 AC 191 could still be justified on grounds of public policy. But the opportunity had been taken of arranging for the case to be heard by seven Law Lords so that it could be considered whether the rule that was established by that case could still be said to be justified. The focus of attention was shifted, quite deliberately, to this issue. The House was no longer interested in the question whether the Court of Appeal had been right to say that the solicitors' conduct was such as not to attract the core immunity. So I did not regard it as necessary for the disposal of the appeal to say that any change as regarded the immunity rule should operate retrospectively. On the contrary, as I said at p 710B:

> "I consider it to be a legitimate exercise of your Lordships' judicial function to declare prospectively whether or not the immunity – which is judge-made rule – is to be available in the future and, if so, in what circumstances."

73. I continue to think that this approach to the exercise of the judicial power in that case was legitimate. There was no need, in order

to do justice between the parties to the disputes, for the decision in *Arthur J S Hall & Son v Simons* [2002] 1 AC 615 to be applied retrospectively. Advocates had arranged their affairs since the decision in *Rondel v Worsley* on the basis that in their conduct of cases in court the core immunity was available. Recognising the importance that is to be attached to legal certainty, there was much to be said for the view that in their case the decision to remove the immunity should operate prospectively only and not retrospectively.

74. Where the future may lead us we cannot tell. So, like my noble and learned friend Lord Nicholls of Birkenhead, I would not rule out the possibility that in a wholly exceptional case the interests of justice may require the House, in the context of a dispute about the state of the common law or even about the meaning or effect of a statute, to declare that its decision is not to operate retrospectively. But I would not consider that approach to be appropriate in this case. The single most important point which indicates the contrary is that, if the decision to overrule *Siebe Gorman* were to be applied prospectively only, it would deprive the preferential claimants of the priority to which, on a correct view of the law, they are entitled under section 175(2)(b) of the 1986 Act. I do not think that it is open to your Lordships in the exercise of the judicial power to deprive a party to the litigation of a legitimate remedy that has undoubtedly been given to him by statute.

Conclusion

75. For the reasons given by Lord Scott and Lord Walker, and for these further reasons of my own, I would hold that the decision in *Siebe Gorman & Co Ltd v Barclays Bank* Ltd [1979] 2 Lloyd's Rep 142 was wrong and should be overruled. I would allow the appeal.

LORD SCOTT OF FOSCOTE

My Lords,

The issues

76. The issue in this case is whether the charge over book debts, present and future, granted by Spectrum Plus Ltd ("Spectrum") to National Westminster Bank Plc ("the bank") under a debenture dated 30 September 1997 was a fixed charge, which it was expressed to be, or merely a floating charge. The bank, naturally, says that it was a fixed charge. Customs & Excise, the Inland Revenue and the Secretary of State for Trade and Industry ("the Crown creditors") say that it was a floating charge. If it was a floating charge Spectrum's preferential creditors are entitled to have their debts paid out of the proceeds of the book debts in priority to the bank (see section 175, Insolvency Act 1986). If it was not a floating charge the preferential creditors have no such priority and the bank will be entitled to the whole of the proceeds. The amount at stake is relatively trivial, no more than £16,136 odd. But this is a test case. Your Lordships have been given to understand that several hundred liquidations are being held up pending the resolution of the issue (see the judgment of the Vice-Chancellor Sir Andrew Morritt [2004] Ch 337, 342). Your Lordships have been told also that the debenture granted by Spectrum was in the bank's normal form and that many other banks and other commercial lenders have taken security over their borrowers' book debts using a similar form of debenture. It is of commercial as well as legal importance that the issue should be resolved.

77. There is a subsidiary issue. The bank has invited your Lordships, if your Lordships conclude that the debenture created merely a floating charge over the book debts, so to rule with prospective effect only. That raises the question whether your Lordships have power to deliver prospective rulings, applicable only in the future, or only to debentures not yet executed. There is also, of course, the question whether, if your Lordships do have such a power, the power should be exercised in the present case. But these are issues for later. The first and main issue is whether the bank's debenture created a fixed charge or only a floating charge over Spectrum's book debts.

The debenture

78. Spectrum carried on the business of a manufacturer of dyes, paints, pigments and other chemical products for the paint industry. In the autumn of 1997 Spectrum changed banks. It opened an account with the bank, obtained an overdraft facility of £250,000 and, on 30 September 1997, executed the debenture to secure its indebtedness to the bank. The security created by the debenture was expressed to include -

> "… [a] specific charge [of] all book debts and other debts … now and from time to time due or owing to [Spectrum]" (para. 2(v))

and

> "[a] floating security [of] its undertaking and all its property assets and rights whatsoever and wheresoever present and/or future including those for the time being charged by way of specific charge pursuant to the foregoing paragraphs if and to the extend that such charges as aforesaid shall fail as specific charges but without prejudice to any such specific charges as shall continue to be effective." (para.2(vii))

79. The expression "specific charge" is potentially ambiguous. It may mean a charge over specific ascertained property or it may mean a fixed charge in contrast to a floating charge, depending on the context. It is clear that in this debenture, as in most others, the expression is intended to bear the latter meaning.

80. There is no doubt that, as Slade J held in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, it is in law possible for a company to create a security consisting of a fixed charge over all its present and future book debts. Nor is there any doubt that the question as to how a particular charge should be categorised depends upon the nature of the rights over the charged asset that have been granted to the chargee or reserved to the chargor. The label that the parties have attributed to the charge may be some indication of the rights the parties were intended to have but is not conclusive.

81. Paragraph 5 of the debenture supported the grant of the charge over books debts -

> "5. With reference to the book debts and other debts hereby specifically charged [Spectrum] shall pay into [Spectrum's] account with the Bank all moneys which it may receive in respect of such debts and shall not without the prior consent in writing of the Bank sell factor discount or otherwise charge or assign the same in favour of any other person or purport to do so and [Spectrum] shall if called upon to do so by the Bank from time to time execute legal assignments of such book debts and other debts to the Bank."

This provision barred Spectrum from dealing with its book debts in any of the ways specified but left Spectrum free to deal with the debtors who owed the debts and, in particular, to collect the debts in the normal course of business.

82. Paragraph 5 required that the debts once collected be paid into Spectrum's account with the bank. This account was a current account. It enjoyed the overdraft facility of £250,000 to which I have referred. Provided that overdraft limit were not exceeded, Spectrum was free to draw on the account for its business purposes. The Bank's Borrowing Terms allowed the bank, by notice, to withdraw or reduce the facility. And amounts outstanding on the account were repayable on demand. These are the normal terms on which overdraft facilities are made available by banks to their customers. This account was in all respects a normal bank current account with an overdraft facility.

83. The question for decision, therefore, is whether a charge over present and future book debts, where the chargor cannot dispose of or charge the uncollected book debts but can deal with its debtors and collect the debts and where the chargor is obliged to place the payments made to it by its debtors in a designated account with the chargee bank but can freely draw on the account for its business purposes provided the overdraft limit is not exceeded, is capable in law of being a fixed charge.

The facts

84. The events that have led to this litigation can be shortly stated. After the opening of the current account in September 1997 Spectrum collected its book debts, paid them into its current account and drew on the account as it wished for its business purposes. The overdraft limit of £250,000 was never exceeded but nor was the account ever in credit. There is no evidence that any instructions regarding Spectrum's drawings from the account or how the account could be used by Spectrum were ever given by the bank or that the bank ever sought to exercise any control over the use made by Spectrum of its withdrawals from the account. But Spectrum's business fortunes did not prosper and on 15 October 2001 it went into voluntary liquidation. At the date of liquidation £165,407 was due to the bank. Spectrum's uncollected book debts at that date had a face value of £291,293, but the liquidators estimated their realisable value to be £156,544. Spectrum's unsecured debts included the £16,136 due to preferential creditors, mainly the Crown creditors. There was a deficiency with regard to creditors in the region of £650,000.

85. The liquidators have so far collected £113,484 in respect of book debts but, pending a resolution of the issue as to the correct categorisation of the charge granted over the book debts, have not accounted for these payments to the bank. Bearing in mind, however, that even if the charge created only a floating charge the bank would be entitled to priority over ordinary creditors and that the amount due to preferential creditors is only £16,136, it seems a little surprising that the liquidators have not accounted to the bank for the balance of the £113,484. But no doubt there is some explanation for this.

The rival lines of judicial authority

86. The issue as to the correct categorisation of the charge created by Spectrum over its book debts has been presented, both in the courts below and before your Lordships, as requiring a choice between rival lines of judicial authority. In *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 Slade J held that the Barclays Bank debenture had created a fixed charge over the chargor's book debts. There are no material differences between the Barclays Bank debenture in issue in the *Siebe Gorman* case and the bank's debenture in the present case, at least so far as concerns the charge of book debts. The *Siebe Gorman* decision was followed by Knox J in *Ex p Copp* [1989]

BCLC 13 and has been referred to without dissent in other cases at first instance (see eg. *In re Portbase Clothing Ltd* [1993] Ch 388 at 395/6). Moreover in *In re New Bullas Trading Ltd* [1994] 1 BCLC 485 the Court of Appeal took *Siebe Gorman* a step further. The *New Bullas* debenture was expressed to grant a fixed charge over the chargor's present and future book debts but a floating charge over the proceeds of the debts when collected and paid into the chargor's bank account. Collection of the debts was left to the chargor. The chargor went into liquidation and Nourse LJ, with whose judgment the other two members of the court agreed, held that the charge over the book debts owing at the date of liquidation was, as the debenture had stated, a fixed charge. If a charge over book debts can be a fixed charge even though the money received by the chargor in payment of those debts is to be subject to only a floating charge, it becomes difficult to quarrel with the proposition that the charge over uncollected book debts in the present case (or in *Siebe Gorman*) can be a fixed charge even though the chargor can freely use for its business purposes the money it receives from its debtors in payment of the debts subject to the charge.

87. However Hoffmann J's judgment in *In re Brightlife Ltd* [1987] Ch 200 cast some doubt on *Siebe Gorman*. Hoffmann J was presented with a debenture expressed to grant a "first specific charge" of the chargor's book debts, present and future. The debenture did not allow the chargor to dispose of or charge the uncollected book debts but left the chargor free to collect the debts, pay the proceeds into its bank account and draw as it wished on that account. Hoffmann J held that the charge was a floating charge. He distinguished *Siebe Gorman* principally on the ground that the *Siebe Gorman* debenture holder was a bank and the debenture had required the collected debts to be paid into the chargor's account at the chargee bank. In *Brightlife* the debenture holder was not a bank and there was no similar restriction. I must revert to this point of distinction. It suffices for the moment to notice that, despite the description of the charge as a "first specific charge", the *Brightlife* charge was held to be a floating charge because the chargor had been left free to collect the debts, to pay the proceeds into its bank account and to use the account as it wished (see p.209). In the *New Bullas Trading Ltd case* Knox J [1993] BCLC 1389, at first instance, followed *In re Brightlife Ltd*, but was reversed by the Court of Appeal. *In re Brightlife Ltd* was followed also by Millett LJ in *In re Cosslett (Contractors) Ltd* [1998] Ch 495.

88. In *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd* [1994] 3 NZLR 300 Tompkins J, sitting in the High Court of New Zealand, declined to follow *Siebe Gorman*. The

debenture in question, as in *Siebe Gorman* and the present case but unlike the debenture in *In re Brightlife Ltd*, was a bank debenture. It was expressed to grant a "fixed charge" over, among other assets, the chargor's book debts present and future. The debenture did not allow the chargor to dispose of or charge its uncollected book debts and required the collected debts to be paid into the chargor's account with the bank. There does not appear to have been any restriction on the ability of the chargor to draw on the account for its trading purposes. Tompkins J noted that "the relevant provisions of the securities in *Siebe Gorman* and the present case are, for practical purposes, the same" (p 318) but held that the charge over the book debts was a floating charge because

> "… a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the Bank. It does not, without more, fasten the charge onto those proceeds".(p 321)

89. And, finally, the same point came before the Privy Council on an appeal from the Court of Appeal of New Zealand in *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710. This case concerned a bank debenture closely modelled on the *New Bullas Trading Ltd* debenture, that is to say, it purported to grant the bank a fixed charge over the chargor's book debts present and future but only a floating charge over the proceeds collected by the chargor (see p 716). The judgment of the Board, delivered by Lord Millett, held that the critical feature which distinguished a floating charge from a fixed charge lay in the chargor's ability, freely and without the chargee's consent, to control and manage the charged assets and withdraw them from the security. *In re Brightlife Ltd*, *In re Cosslett (Contractors) Ltd* and the New Zealand *Supercool Refrigeration* case were approved and applied. *New Bullas Trading Ltd* was held to have been wrongly decided. *Siebe Gorman* was treated, in rather guarded terms, as a case in which Slade J had found sufficient restrictions on the use to which the chargor could put the collected debt payments to warrant the categorisation of the charge as a fixed charge (p 727). But Lord Millett expressed the opinion, at para 36, that

> "A restriction on disposition [of book debts] which nevertheless allows collection and free use of the proceeds is inconsistent with the fixed nature of the charge; it

allows the debt and its proceeds to be withdrawn from the security by the act of the company in collecting it"

The judgments in the courts below

90. The issue has, in the present case, been litigated between the bank on the one side, arguing for a fixed charge, and the Crown creditors on the other side, arguing for a floating charge. Spectrum in liquidation and its liquidators, although parties to the proceedings, have taken no active part.

91. The Vice-Chancellor, having reviewed the cases, said that he was persuaded by Lord Millett's reasoning in *Agnew* that *Siebe Gorman* had been wrongly decided. He held that the charge granted to the bank over Spectrum's book debts was, notwithstanding that it was expressed to be a fixed charge, in law a floating charge. The test, he held, was whether the rights and obligations conferred and imposed by the debenture "disclosed an intention that the company should be free to deal with the book debts and withdraw them from the security without the consent of the Bank" (para 39). The application of this test should, said the Vice-Chancellor, have led to the conclusion in *Siebe Gorman* that the charge was a floating charge: he said "the collection and free use of the proceeds of book debts through the ordinary operation of the bank account was not only permitted but envisaged" (para 39).

92. The Vice-Chancellor referred in his judgment to the criticisms of the Court of Appeal decision in *In re New Bullas Trading Ltd* that had been made by Lord Millett in *Agnew* and to earlier criticisms of that decision made by Professor Roy Goode in an article, "Charges Over Book Debts: A Missed Opportunity" (1994) 10 LQR 592, but did not himself address Nourse LJ's reasoning or conclusions.

93. The Court of Appeal did so, however, when the present case reached them. The Master of the Rolls, Lord Phillips of Worth Matravers, pointed out, correctly in my respectful opinion, that the Vice-Chancellor's test of a floating charge was in conflict with the Court of Appeal decision in *New Bullas Trading* and concluded that the rules of binding precedent enabled neither the Vice-Chancellor nor a subsequent Court of Appeal to rule that that case had been wrongly decided (para 58). This conclusion would, I think, have made it inevitable that the appeal against the Vice-Chancellor's judgment would have been

allowed but the Master of the Rolls went on to consider whether, assuming the *Agnew* test of a floating charge to be applicable, the bank's debenture had had the effect that the company had been left free to use the proceeds of its book debts in the normal course of its business. He concluded that the restrictions imposed by the debenture (and the restrictions imposed by the *Siebe Gorman* debenture) had been sufficient to justify the categorisation of the charge as a fixed charge:

> "It seems to me that it is at least arguable that a debenture which prohibits a chargor from disposing of book debts before they are collected and requires him to pay them, beneficially, to the chargee as and when they are collected properly falls within the definition of a fixed charge, regardless of the extent of his contractual right to draw out sums equivalent to the amount paid in. Strictly speaking the chargor is neither entitled to dispose of the book debts before they fall due for payment, nor to dispose of the proceeds. What he does enjoy are contractual rights to payments, whether as lender or borrower, from the bank" (para 94).

94. On this appeal, therefore, the main issue depends on two questions. First, what is the right test to be applied in order to categorise a charge as a floating charge? Second, if that test is applied in the present case, how should the bank's charge be categorised?

What is a floating charge?

95. It is helpful in answering this question to bear in mind the juridical history of floating charges and the reasons why a degree of statutory intervention became necessary. By the middle of the 19th century industrial and commercial expansion in this country had led to an increasing need by companies for more capital. Subscription for share capital could not meet this need and loan capital had to be raised. But the lenders required security for their loans. Traditional security, in the form of legal or equitable charges on the borrowers' fixed assets, whether land or goods, could not meet the need. The greater part of most entrepreneurial companies' assets would consist of raw materials, work in progress, stock-in-trade and trade debts. These were circulating assets, replaced in the normal course of business and constantly changing. Assets of this character were not amenable to being the subject of traditional forms of security. Equity, however, intervened.

Holroyd v Marshall (1862) 10 HLC 191 was a case in which a debtor had purported to grant a mortgage not only over his existing machinery but also over all the machinery which, during the continuance of the security, should be placed in his mill. The question arose whether the equitable title of the chargee in respect of new machinery that had been placed in the mill prevailed over the rights of a judgment creditor of the chargor/debtor. Could the chargee assert an equitable interest in the new machinery? Lord Campbell LC held that he could not. But the House of Lords reversed the decision, holding that

> "…immediately on the new machinery and effects being fixed or placed in the mill, they became subject to the operation of the contract, and passed in equity to the mortgagees" (per Lord Westbury at p 211)

and that

> "… in equity it is not disputed that the moment the property comes into existence, the agreement operates on it" (per Lord Chelmsford at p 220).

96. *Holroyd v Marshall* opened the way to the grant by companies of security over any class of circulating assets that the chargor company might possess. Acceptance that it was possible to do this became established by the 1870s. In *In re Panama New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318 the company simply charged its "undertaking and all sums of money arising therefrom". Gifford LJ held, at p 322, that "undertaking" meant

> "… all the property of the company, not only which existed at the date of the debenture, but which might afterwards become the property of the company."

He said also that the word "undertaking"

> "… necessarily infers that the company will go on, and that the debenture holder could not interfere until either the interest which was due was unpaid, or until the period

had arrived for the payment of his principal, and that principal was unpaid".

(see also *In re Florence Land and Public Works Co* [1878] 10 Ch D 530, 540).

The two features mentioned by Gifford LJ became the hallmark of the new form of security, namely, (1) a charge on the chargor company's assets, or a specified class of assets, present and future and (2) the right of the chargor company to continue to use the charged assets for the time being owned by it and to dispose of them for its normal business purposes until the occurrence of some particular future event. In *In re Colonial Trusts Corporation* (1879) 15 Ch D 465 Jessel MR referred to this form of security as a "floating security" (see at pp 468, 469 and 472) and in *Moor v Anglo-Italian Bank* (1879) 10 Ch D 681, 687 he contrasted the new form of security with a "specific charge" on the property of the company.

97. By the last decade of the 19th century this form of security, Jessel MR's "floating security", had become firmly established and in regular use. This new form of security, the floating charge, did not derive from statute. It had been bred by equity lawyers and judges out of the needs of the commercial and industrial entrepreneurs of the time. But the new form of security, notwithstanding its convenience for both borrowers and lenders, had its drawbacks for others. Those dealing with a company could not tell whether its circulating assets were subject to a charge that, if the company became insolvent or ceased business, would allow a debenture holder to "step in and sweep off everything" (Lord Macnaghten in *Salomon v Salomon & Co. Ltd* (1897) 10 AC 22, 53). And if a debenture holder did "step in and sweep off everything" there would be nothing left for unsecured creditors including, in particular, the company's employees to whom wages arrears might be owing.

98. Statutory intervention began in 1897 with the Preferential Payments in Bankruptcy Amendment Act. Where a company was being wound-up or was in receivership sections 2 and 3 of the 1897 Act gave preferential creditors, a class which included employees as well as Crown creditors, priority over the chargee under a floating charge, so far as payment of debts out of the assets subject to that charge was concerned. Preferential creditors had priority anyway over ordinary creditors and the sections did not disturb the priority over ordinary creditors to which the charge holder was entitled by virtue of the charge.

These statutory provisions, with very little alteration, are now to be found in sections 40 (receivership) and 175 (winding-up) of the Insolvency Act 1986. And in 1900 further statutory interventions required floating charges to be registered: (see now sections 395 and 396, Companies Act 1985) and provided for floating charges created by an insolvent company within a short period before the commencement of its winding-up to be invalid except to the extent of new money provided by the chargee (see now section 245 Insolvency Act 1986). The statutes which first introduced these reforms did not attempt any definition of a "floating charge". Nor have any of their statutory successors done so. The expression has been taken to be self-explanatory. It bears the meaning attributed to it by judicial decision. But the judicial process over the years whereby the concept of a "floating charge" has been developed must, in my opinion, keep in mind the mischief that these statutory reforms were intended to meet and, in particular, that on a winding-up or receivership preferential creditors were to have their debts paid out of the circulating assets, sometimes referred to as "ambulatory" assets, of the debtor company in priority to a debenture holder with a charge over those assets.

99. The classic and frequently cited definition of a floating charge is that which was given by Romer LJ in the Court of Appeal in the *Yorkshire Woolcombers Association* case [1903] 2Ch 284, 295.

> "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 further 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."

But it is important to notice that Romer LJ prefaced his definition with a qualification. He said -

> "I certainly do not intend to attempt to give an exact definition of the term 'floating charge', nor am I prepared

> to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics …".

The case came to this House under the name *Illingworth v Houldsworth* [1904] AC 355. In short *ex tempore* speeches their Lordships upheld the Court of Appeal. Lord Macnaghten described the case as "clear" and offered the following definition of a floating charge in contrast to a "specific charge" -

> "A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp"(p 358).

100. And a few years later Buckley LJ in *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979, 999 similarly contrasted a "floating security" with a "specific security".

> "[A floating security] is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security".

101. It is in the nature of commercial lenders to want the most effective security that they can get. It is in the nature of commercial borrowers to want to be able to carry on the business for the purposes of which they are borrowing money with as much freedom from restrictions imposed by their lenders that negotiation can achieve for

them. But the lenders are usually in the stronger bargaining position and able to stipulate the terms to be included in the debenture which will constitute their security. So it is not in the least surprising to find attempts by lenders to obtain fixed charges as security rather than floating charges, thereby avoiding the need, if financial misfortune were to visit their borrowers, to yield priority to preferential creditors and also avoiding possible vulnerability under section 245 of the 1986 Act or its statutory predecessors. And it is not surprising to find borrowers agreeable to co-operate in these attempts provided their ability to carry on business in the normal way were not unduly impeded.

102. There was never any doubt that it was possible to create a fixed charge over a specific, ascertained book debt. And *Tailby v The Official Receiver* (1888) 13 App Cas 523 established that an assignment of future book debts would be effective to vest in the assignee an equitable interest in the future debts at the moment they became owing to the assignor. So there was no reason why a debenture should not be expressed to assign to the debenture holder, by way of security, the company's future book debts. But the question would still remain whether such an assignment, not being an out-and-out assignment as in *Tailby v The Official Receiver* but an assignment by way of security, could be said to constitute a fixed security.

103. There was nothing much that the lenders could do about the third of the characteristics that Romer LJ had regarded as typical of floating charges. Most commercial borrowers would be unlikely to agree to grant charges over their circulating assets that did not enable them to use those assets for their normal business purposes. So it was natural for the quest for fixed charges to be concentrated on the prominence given by Lord Macnaghten in the *Yorkshire Woolcombers* case to the characteristic of a fixed charge as being a charge on "ascertained and definite property" As soon as a book debt is incurred and becomes owing to the chargor it constitutes an item of "ascertained and definite" property and would qualify as a possible object of a fixed charge. So a debenture expressed to grant a fixed charge over present and future book debts would be capable of creating a fixed charge over all such debts as and when they accrued due to the chargor company. Slade J so held in *Siebe Gorman* and no-one has suggested that in that respect he was wrong.

104. Moreover, the debenture could fortify the apparently fixed character of the charge by including a provision entitling the chargee to call for a formal written assignment by the chargor of the debts as they

accrued. Such an assignment unaccompanied by written notice to the debtor would constitute the chargee equitable proprietor, and not simply equitable chargee, of the debt. The appearance of a fixed security would be fortified. It is not surprising, therefore, to find debentures containing provisions of this sort. The *Siebe Gorman* debenture did so. So did the bank's debenture in the present case. But the intention of the parties that the charge over book debts created and fortified in this way would be a fixed charge has to take account also of Romer LJ's third characteristic of a floating charge, namely, that until some further step by way of intervention is taken by the chargee the chargor company can use the assets in question for its normal business purposes and, in using them, remove them from the security. The fact that a valid fixed charge over present and future book debts is capable of being created does not answer the essential question whether a fixed charge over assets that remain at the disposal of the chargor can be created.

105. Slade J in *Siebe Gorman* [1979] 2 Lloyd's Rep 142, 158 inclined to the opinion that if the chargor of book debts, having collected the book debts,

> "… [had] had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit … the charge on such book debts could be no more than a floating charge."

Hoffmann J in *In re Brightlife Ltd* [1987] Ch 200, 209, in a passage cited with approval by Lord Millett in *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710, 723, said that the significant feature of the *Brightlife* debenture was that the company was free to collect its debts and pay the proceeds into its bank account. He went on

> "Once in the account, they would be outside the charge over debts and at the free disposal of the company. In my judgment a right to deal in this way with the charged assets for its own account is a badge of a floating charge and is inconsistent with a fixed charge."

Similar conclusions were expressed in *In re Keenan Bros Ltd* [1986] BCLC 242 in the Supreme Court of Ireland and by Tompkins J in the *Supercool Refrigeration* case [1994] 3 NZLR 300, in New Zealand.

106. The Privy Council in the *Agnew* case agreed with these decisions. Lord Millett pointed out, in para 13 of the Board's opinion, that Romer LJ's first two characteristics, although typical of a floating charge, were not distinctive of it. They were not necessarily inconsistent with a fixed charge. It was the third characteristic, Lord Millett said, which was the hallmark of a floating charge and distinguished it from a fixed charge.

107. I respectfully agree. Indeed if a security has Romer LJ's third characteristic I am inclined to think that it qualifies as a floating charge, and cannot be a fixed charge, whatever may be its other characteristics. Suppose, for example, a case where an express assignment of a specific debt by way of security were accompanied by a provision that reserved to the assignor the right, terminable by written notice from the assignee, to collect the debt and to use the proceeds for its (the assignor's) business purposes, ie, a right, terminable on notice, for the assignor to withdraw the proceeds of the debt from the security. This security would, in my opinion, be a floating security notwithstanding the express assignment. The assigned debt would be specific and ascertained but its status as a security would not. Unless and until the right of the assignor to collect and deal with the proceeds were terminated, the security would retain its floating characteristic. Or suppose a case in which the charge were expressed to come into existence on the future occurrence of some event and then to be a fixed charge over whatever assets of a specified description the chargor might own at that time. The contractual rights thereby granted would, in my opinion, be properly categorised as a floating security. There can, in my opinion, be no difference in categorisation between the grant of a fixed charge expressed to come into existence on a future event in relation to a specified class of assets owned by the chargor at that time and the grant of a floating charge over the specified class of assets with cystallisation taking place on the occurrence of that event. I endeavoured to make this point in *In re Cosslett (Contractors) Ltd* [2002] 1 AC 336, 357, para 63. Nor, in principle, can there be any difference in categorisation between those grants and the grant of a charge over the specified assets expressed to be a fixed charge but where the chargor is permitted until the occurrence of the specified event to remove the charged assets from the security. In all these cases, and in any other case in which the chargor remains free to remove the charged assets from the security, the charge should, in principle, be categorised as a floating charge. The assets would have the circulating, ambulatory character distinctive of a floating charge.

108. The debenture in the *New Bullas Trading* case [1994] 1 BCLC 485 had features which illustrate the ingenuity of equity draftsmen in

seeking to produce for their clients fixed charges out of circumstances that would normally be associated with floating charges. The debenture was expressed to grant the chargee a fixed charge over the company's present and future book debts. The chargee was entitled to demand that the debts be assigned to it, but never in fact made any such demand. The chargee was entitled to give the chargor instructions as to how the chargor should deal with its book debts, but apparently never in fact gave any such instructions, at any rate none prior to liquidation. The debenture left the chargor free to collect the debts and required the chargor to pay into a specified bank account all money it received in payment of the debts. The debenture then provided that on payment of the money into the bank account the fixed charge would be released and replaced by a floating charge over the money in the account. The obvious intention of these provisions was that on the occurrence of a crystallisation event, eg liquidation, the uncollected book debts at that time would be subject to the fixed charge notwithstanding that if the debts had been paid prior to the crystallisation event the collected money would have been subject to only a floating charge. The preferential creditors would then enjoy no priority over the debenture holder so far as the uncollected debts were concerned.

109. Nourse LJ could see no reason in law to prevent the parties from providing for a fixed charge on book debts while uncollected but a floating charge on the money collected. He referred at p 492 to the question and answer posed by Lord Macnaghten in *Tailby v Official Receiver* 13 App Cas 523, 545 -

> "Between men of full age and competent understanding ought there to be any limit to the freedom of contract but that imposed by positive law or dictated by considerations of morality or public policy? The limit proposed is purely arbitrary, and I think meaningless and unreasonable."

These reservations, he thought, supported the view that it was open to contracting parties, if they wished to do so, to provide for a fixed charge on uncollected book debts but a floating charge on the money received in payment of those debts.

110. Lord Millett expressed the Board's disagreement with Nourse LJ's reasoning and conclusion. Essentially Lord Millett challenged the notion that the security rights granted over a book debt could be any greater than the rights, if any, granted over the money received in

payment of the debts (see [2001] 2 AC 710, para 46). If a book debt were to be charged as security but with an accompanying provision that any money received from the debtor in payment of the debt would belong to the chargor, the so-called 'charge', whether expressed to be a fixed charge or a floating charge, would not be a security at all. It would not constitute a possible source for the repayment of the allegedly secured debt. As Lord Millett said, it would be worthless. If the accompanying provision were, instead, to say that any money received from the debtor would be subject to a floating charge, that provision would, in my opinion, necessarily describe and limit the nature of the charge over the receivable debt. And if the charge were to be expressed to be a fixed charge as respects the receivable debt but a floating charge as respects the money received from the debtor there would be an internal contradiction in the formulation of the charge. Since the essential value of a book debt as a security lies in the money that can be obtained from the debtor in payment it seems to me that Lord Millett was right in concluding that such a security should be categorised as a floating security and that *New Bullas* [1994] 1 BCLC 485 was wrongly decided.

111. In my opinion, the essential characteristic of a floating charge, the characteristic that distinguishes it from a fixed 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 to remove it from the security. On this point I am in respectful agreement with Lord Millett. Moreover, recognition that this is the essential characteristic of a floating charge reflects the mischief that the statutory intervention to which I have referred was intended to meet and should ensure that preferential creditors continue to enjoy the priority that section 175 of the 1986 Act and its statutory predecessors intended them to have.

Did the bank's debenture create a fixed charge or only a floating charge?

112. If, as I think, the hallmark of a floating charge and a characteristic inconsistent with a fixed charge is that the chargor is left free to use the assets subject to the charge and by doing so to withdraw them from the security, how should the charge over book debts granted by the bank's debenture be categorised? The following features of the debenture and the arrangements regarding the bank account into which the collected debts had to be paid need to be taken into account.

(1) The extent of the restrictions imposed by the debenture (para 81 above)
(2) The rights retained by Spectrum to deal with its debtors and collect the money owed by them (para 81 above)
(3) Spectrum's right to draw on its account with the bank into which the collected debts had to be paid, provided it kept within the overdraft limit (para 82 above)
(4) The description "fixed charge" attributed to the charge by the parties themselves.

113. Restrictions on Spectrum's right to deal with its uncollected book debts go very little way, in my opinion, in supporting the characterisation of the charge as a fixed charge for the reasons I have given in criticising the *New Bullas* decision. It is restrictions on the use that Spectrum could make of the payments made by its debtors that are important. I have already cited the passage at p.158 from Slade J's judgment in *Siebe Gorman*[1979] 2 Lloyd's Rep 142, 158 (para 105 above) and need not repeat it. It makes the same point.

114. Moreover, the restrictions on Spectrum's right to deal with its uncollected book debts did not enable the bank to realise its security over those uncollected book debts. The bank could not have sold the book debts without first taking some step or steps that would have given it the power to do so. In effect a crystallisation event would, I think, have had to take place. The value of the uncollected book debts as a security lay always in the money that could be obtained from the debtors in payment of those debts.

115. The bank's debenture required all payments of book debts received by Spectrum to be paid into its account with the bank. The money once received by the bank would become the bank's money and in return Spectrum's account would be credited with the amount that had been received. Whether the account was for the time being in credit or in debit the result of each payment would be the accrual to Spectrum of the right to withdraw from the account a corresponding amount for its normal business purposes.

116. An attempt has been made to justify the categorisation of the charge as a fixed charge by looking no further than the receipt by the bank, through the operation of the clearing system, of the proceeds of the cheques from Spectrum's debtors that were paid in by Spectrum.

The consequent crediting of Spectrum's account with amounts equal to the proceeds of the cheques and Spectrum's ability to draw on that account for its business purposes is not inconsistent, it is suggested, with the categorisation of the charge over the book debts as a fixed charge. This is the point being made by the Master of the Rolls in para 94 of his judgment (cited in para 93 above). It was a point pressed before your Lordships by Mr Moss QC, counsel for the bank. Your Lordships should not, in my opinion, accept this argument. It seeks to perpetuate what I regard as the *New Bullas* heresy, namely, that the categorisation of a charge over book debts can ignore the rights of the chargor over the money received in payment of those debts. The expression "floating charge" has never been a term of art but is an expression invented by equity lawyers and judges to describe the nature of a particular type of security arrangement between lenders and borrowers. The categorisation depends upon the commercial nature and substance of the arrangement, not upon a formalistic analysis of how the bank clearing system works. If part of the arrangement is that the chargor is free to collect the book debts but must pay the collected money into a specified bank account, the categorisation must depend, in my opinion, on what, if any, restrictions there are on the use the chargor can make of the credit to the account that reflects each payment in.

117. The bank's debenture placed no restrictions on the use that Spectrum could make of the balance on the account available to be drawn by Spectrum. Slade J in *Siebe Gorman* [1979] Lloyd's Rep 142, 158 thought it might make a difference whether the account were in credit or in debit. I must respectfully disagree. The critical question, in my opinion, is whether the chargor can draw on the account. If the chargor's bank account were in debit and the chargor had no right to draw on it, the account would have become, and would remain until the drawing rights were restored, a blocked account. The situation would be as it was in *In re Keenan Bros* Ltd [1986] BCLC 242. But so long as the chargor can draw on the account, and whether the account is in credit or debit, the money paid in is not being appropriated to the repayment of the debt owing to the debenture holder but is being made available for drawings on the account by the chargor.

118. Slade J said that the debenture in the *Siebe Gorman* case

> "… creat[ed] in equity a specific charge on the proceeds of [the book debts] as soon as they are received and consequently prevents the mortgagor from disposing of an unencumbered title to the subject matter of such charge

> without the mortgagee's consent, even before the mortgagee has taken steps to enforce its security". (p 159)

But it is very difficult to see what feature of the arrangement between chargor and bank chargee in *Siebe Gorman* justified this conclusion. The debenture was on all fours with the debenture in the present case. There is nothing in the report of the case to suggest that the bank account into which the chargor had to pay the collected book debts was other than, as here, a normal bank current account on which the chargor could draw for its normal business purposes. In considering the cited passage it seems to me worth noting that the issues that Slade J had to decide in the *Siebe Gorman* case did not include the question whether the charge over book debts was a fixed charge or a floating charge. The main issue in the case was one of priority as between the bank chargee on the one hand and a subsequent assignee of the charged book debts on the other. This issue turned on notice. Did the subsequent assignee have notice of the bank's charge and the provision barring subsequent assignments? If the subsequent assignee did have notice, the bank would have priority. If not, the subsequent assignee would have priority. The categorisation of the charge did not matter.

119. Slade J in *Siebe Gorman*, Nourse LJ in the *New Bullas* case, and Mr Moss QC in his submission on behalf of the bank in the present case, attributed considerable significance to the labels that the parties to the debenture had chosen to attribute to the charge over book debts. Mr Moss indeed argued that a debenture expressed to grant a fixed charge thereby limited by necessary implication the ability of the chargor to deal with the charged assets. He argued that Spectrum had no right without the consent of the bank to draw on the account into which the cheques received by Spectrum in payment of its book debts had to be paid. This limitation was, he said, an inevitable result of the grant by the debenture of the fixed charge. This argument, my Lords, puts the cart before the horse. The nature of the charge depends on the rights of the chargor and chargee respectively over the assets subject to the charge. The moneys in the bank account were assets subject to the charge. If the account had been treated as a blocked account, so long as it remained overdrawn, it would be easy to infer from a combination of that treatment and the description of the charge as a fixed charge that Spectrum had no right to draw on the account until the debit on the account had been discharged. But the account was never so treated. The overdraft facility was there to be drawn on by Spectrum at will. In the operation of the account there was never a suggestion that Spectrum needed to obtain the bank's consent before writing a cheque. The bank could, by notice, have terminated the overdraft facility, required

immediate repayment of the indebtedness and turned the account into a blocked account. Pending such a notice, however, Spectrum was free to draw on the account. Its right to do so was inconsistent with the charge being a fixed charge and the label placed on the charge by the debenture cannot, in my opinion, be prayed–in-aid to detract from that right.

120. The correct conclusion, in my opinion, is that the debenture, although expressed to grant the bank a fixed charge over Spectrum's book debts, in law granted only a floating charge. I think the Vice-Chancellor, save for the precedent point, was correct in his reasoning and his conclusion.

Prospective overruling

121. Mr Moss has submitted on behalf of the bank that if your Lordships should conclude that the *Siebe Gorman* debenture ought to have been held to have created a floating charge over the book debts your Lordships should so rule with prospective effect only. I take this submission to mean that the overruling of *Siebe Gorman* would not affect any debenture granted before the date on which your Lordship's opinions were made public. This submission raises two questions. The first is whether your Lordships, having come to a conclusion on some issue of disputed law and ruled accordingly, have any power to postpone the coming into effect of that ruling. The second question, if your Lordships do have that power, is whether this is a case in which it should be exercised.

122. My Lords, I find the second question a very easy one. I can see no good reason for postponing the effect of the overruling of *Siebe Gorman.* If *Siebe Gorman* had been a decision of this House and therefore, subject to subsequent legislative intervention or to an overruling of the decision pursuant to the 1966 Practice Statement (Judicial Precedent) [1966] 1 WLR 1234, a decision that settled the law with finality, I think your Lordships would have need to hesitate long before overruling. But the rulings of lower courts on points of law do not settle the law with finality. They never have done. It was natural that banks and other lenders taking security from corporate borrowers should have modelled their security on the debenture form that had achieved success in *Siebe Gorman*. But they would not, or at least should not, have done so on the footing that Slade J's judgment had finally settled the law. Mr Moss has submitted that the bank's lending decisions, whether to lend, how much to lend, how much interest to

charge, and so on, were taken in the belief that the *Siebe Gorman* decision on fixed charges over book debts would stand, and that otherwise different decisions might have been taken. My Lords, I am highly sceptical. Banks are in business to receive and hold money for their customers and to lend on that money to others who want to borrow. This is a highly competitive business. The proposition, that the terms on which the bank would have allowed Spectrum a £250,000 overdraft facility would have been significantly different if it had known that its charge over Spectrum's present and future books would be no more than a floating charge, is one that, for me, carries no ring of conviction whatever.

123. The question whether the House has power to postpone the coming into effect of a ruling on a point of law does not, therefore, strictly arise. But your Lordships have had the advantage of detailed submissions on the point, not only from counsel for the bank and for the Crown creditors but also from Mr Ian Glick QC, who was appointed by the Attorney General, at their Lordships' request, to act as *amicus curiae* to assist your Lordships on this point. In these circumstances I think I should express my view on the point.

124. The question whether judges in giving judgments make law or simply declare existing law is one that has been debated by generations of law students in universities and law schools across the globe. It will continue to be so. There is no single and absolute answer. There is no doubt that it is one of the functions of judges in a common law country to try and develop the common law so that it serves the needs of the time. To that extent at least it is not controversial to say that judges make new law and it may be that in this area it would be open to the House to give a prospective ruling as to what the law would require of individuals in particular situations. Your Lordships' opinions in *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773 may be regarded as an example.

125. But where the issue is as to the meaning of and effect that should be given to a statutory provision on which the rights of the litigating individuals turn, different considerations come into play. It may be a function of judges incrementally to develop the common law, but it is a duty of judges faithfully to interpret and apply the statutory law. This duty applies as much to the "always speaking" statute as to other statutes. The notion that a judge could decide what a statute meant and required and then announce that the effect of the ruling would be postponed for some period or other seems to me inconsistent with that

duty. It is for Parliament, not judges, to decide when statutes are to come into effect. It is for judges to interpret and apply the statutes. Where interpretation and application of a statute is the issue, a prospective ruling would absent legislative authority (eg the provisions in the 1998 devolution legislation: see para 17 of the opinion of my noble and learned friend Lord Nicholls of Birkenhead), appear to constitute an improper usurpation by the judiciary of the role of the legislature.

126. Lord Nicholls has reviewed in depth the jurisprudential pros and cons of a prospective overruling and has concluded that, even where interpretation and application of a statute is the issue, the door should be kept open for the possibility of such a ruling in an exceptional case (see para 39 of his opinion). I would respectfully agree with his comment about the wisdom of a "never say never" approach but find myself unable to visualise circumstances in which it would be proper for a court, having reached a conclusion as to the correct meaning of a statute, to decline to apply to the case in hand the statute thus construed. Section 1 of the Bill of Rights 1688 declared that

> "… the pretended power of suspending of laws or the execution of laws by regall authority without consent of Parliament is illegall."

It is probably right that the exercise of judicial authority is not caught by the reference to "regall authority" in the Bill of Rights but your Lordships in this House exercise an appellate jurisdiction deriving from the Queen in Council and if the promoters of the Bill of Rights in 1688 had been asked whether there was a power in the House of Lords to suspend laws without the consent of Parliament I do not think it is difficult to guess what their answer would have been.

127. The present case requires a decision as to whether the bank's charge over Spectrum's book debts was a fixed charge or a floating charge. The decision is necessary because statute has given statutory priority to preferential creditors over debenture holders so far as payment of debts out of assets subject to a floating charge is concerned. If your Lordships decide the charge was a floating charge, it is not, in my opinion, open to your Lordships to deprive the preferential creditors of the rights given to them by statute. To do so would be to suspend a law that Parliament has enacted and would, in my opinion, be contrary to the spirit and, perhaps, the letter of the Bill of Rights.

Conclusion

128. For all these reasons, and for the reasons given by my noble and learned friend, Lord Walker of Gestingthorpe, with which I agree, I would allow this appeal and restore paragraphs 1 and 2 of the order of the Vice-Chancellor. The bank must pay the costs here and below.

LORD WALKER OF GESTINGTHORPE

My Lords,

129. I agree that this appeal should be allowed, and that the normal effect of allowing the appeal should not be limited in any way. I gratefully adopt the summary of the facts in the opinion of my noble and learned friend, Lord Scott of Foscote. I agree with his opinion on the substantive issue, and also with that of my noble and learned friend, Lord Hope of Craighead. But because of the general interest and importance of this appeal I wish to state my opinion in my own words.

The history of the floating charge

130. The origins and early history of the floating charge have been clearly explained in a lengthy passage in the opinion of the Privy Council, delivered by Lord Millett, in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 717-721, paras 5-15. This passage shows how the development of the floating charge was enthusiastically encouraged by some of the great Chancery judges of the late 19th century, who were robust defenders of freedom of contract. But after the floating charge had, with great rapidity, grown to maturity, there was something of a reappraisal. The floating charge had become a cuckoo in the nest of corporate insolvency.

131. Two quotations from speeches of Lord Macnaghten, eight years apart, serve to illustrate this. In *Tailby v Official Receiver* (1888) 13 App Cas 523, 545, he said,

> "It was admitted by the learned counsel for the respondent, that a trader may assign his future book debts in a specified business. Why should the line be drawn there? Between men of full age and competent understanding ought there to be any limit to the freedom of contract but that imposed by positive law or dictated by considerations of morality or public policy?"

But in *Salomon v Salomon & Co Ltd* [1897] AC 22, 53, he said,

> "For such a catastrophe as has occurred in this case some would blame the law that allows the creation of a floating charge. But a floating charge is too convenient a form of security to be lightly abolished. I have long thought, and I believe some of your Lordships also think, that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is."

132. *Salomon v Salomon & Co Ltd* was decided by this House on 16 November 1896. With remarkable promptness Parliament responded by enacting sections 2 and 3 of the Preferential Payments in Bankruptcy Amendment Act 1897 ("the 1897 Act"), applicable in winding-up and receivership respectively. These provisions did not give preference to the trade creditors whom Lord Macnaghten had in mind, but the mischief aimed at was the "scandal" to which Lord Macnaghten had referred. The widespread use of floating charges over trading stock, book debts and other circulating capital produced a situation in which a company's business might appear to be thriving and prosperous, with goods on its shelves and customers at its doors, until a sudden and unexpected crystallisation of a floating charge revealed that nothing at all was left for the company's unsecured creditors, even if they were preferential creditors.

133. The perceived mischief was therefore akin to that underlying the doctrine of reputed ownership in bankruptcy, that creditors should not be misled by appearances. The requirement for registration of floating charges, first introduced in 1900, had the same aim, and was comparable

to the requirement for registration of bills of sale. In the United States of America the courts took the same line of thought a good deal further, and rejected floating charges as fraudulent in character: *Wallace Benedict, Receiver v Ratner* (1925) 268 US 353.

134. Sections 2 and 3 of the 1897 Act provided for the claims of preferential creditors to rank ahead of those secured by a floating charge. In doing so it referred to a "floating charge" without providing any statutory definition of that expression. Parliament evidently regarded the concept of a floating charge as sufficiently certain in meaning as not to require definition. Parliament took the same course when registration of floating charges was introduced in 1900, and in all later relevant statutes. The lack of a statutory definition, and the difficulties of providing a clear and comprehensive definition, were discussed by the Court of Appeal in *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 (especially a much-cited passage in the judgment of Romer LJ at p295) and by this House on appeal in the same case under the name of *Illingworth v Houldsworth* [1904] AC 55.

Upgrading the security to a fixed charge

135. These difficulties have not diminished over the years. Sections 2 and 3 of the 1897 Act (now re-enacted, with a refinement as to timing, as sections 175 (2) (b) and 40 (2) respectively of the Insolvency Act 1986) make a floating charge more precarious as a security. Banks and other large commercial lenders have therefore tried, for understandable reasons, to upgrade their security by imposing fixed (and not merely floating) charges on parts of a trading customer's circulating capital, especially book debts. This chapter of commercial history has been described by Professor Sir Roy Goode QC, *Legal Problems of Credit and Security*, 3rd ed. (2003) pp121-123. In practice, most standard forms of debenture make the charge extend not just to book debts but to all present and future "book debts and other debts", the extent of which expression was considered by Hoffmann J in *In re Brightlife Ltd* [1987] Ch 200, 204-5; but nothing turns on that in this appeal. In considering the practical effect of charges on debts it should be borne in mind that money paid into a trading company's bank account will not necessarily represent the proceeds of debts of any description, especially if the trader is a retailer making a large number of cash sales, either over the counter or on a "cash with order" basis.

136. Banks and their advisers have had some success in their efforts to upgrade their security. It is quite clear that a fixed charge on book debts, present and future, is conceptually possible. That was the most important point decided (or at any rate confirmed) by Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, and the Crown, the appellant in this appeal, does not seek to cast any doubt on that general proposition. The Crown challenges the decision on a much narrower point, that is the correct construction of the particular form of debenture which was before the Court. But that narrow point is itself of considerable general importance because the *Siebe Gorman* form has become a precedent and has been widely used, either in precisely the same words or in very similar words, by numerous banks.

137. In *Siebe Gorman*, Slade J decided that the form of debenture before him did on its true construction restrict the borrower, R H McDonald Ltd ("McDonald") in making use of the proceeds of collected debts in the ordinary course of its business. Slade J clearly accepted that, in the absence of such a restriction, the charge on debts could not as a matter of law have been more than a floating charge, even though the parties described it as a fixed (or specific) charge. He said at p 158,

> "if I had accepted the premise that [McDonald] would have had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit, I would have been inclined to accept the conclusion that the charge on such book debts could be no more than a floating charge."

The Crown has little quarrel with that, except perhaps for the adjective "unrestricted."

The essential difference

138. This passage brings us close to the issue of legal principle, that is the essential difference between a fixed charge and a floating charge. 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. The chargee may have good commercial reasons for agreeing to a partial release. If for

instance a bank has a fixed charge over a large area of land which is being developed in phases as a housing estate (another example of a fixed charge on what might be regarded as trading stock) it might be short-sighted of the bank not to agree to take only a fraction of the proceeds of sale of houses in the first phase, so enabling the remainder of the development to be funded. But under a fixed charge that will be a matter for the chargee to decide for itself.

139. Under a floating charge, by contrast, the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a *fund* of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the trader, and not the bank, to decide how to run its business. There is a detailed and helpful analysis of the matter, with full citation of authority, in Professor Sarah *Worthington's Proprietary Interests in Commercial Transactions* (1996) pp 74-77; see also her incisive comment on this case ("An Unsatisfactory Area of the Law—Fixed and Floating Charges Yet Again") in (2004) 1 International Corporate Rescue 175. So long as the company trades in the ordinary way (a requirement emphasised by Romer L J in the *Yorkshire Woolcombers* case [1903] Ch 284, 295, and by the Earl of Halsbury on appeal in the same case, [1904] AC 355, 357-8) the constituents of the charged fund are in a state of flux (or circulation). Trading stock is sold and becomes represented by book debts; these are collected and paid into the bank; the trader's overdraft facility enables it to draw cheques in favour of its suppliers to pay for new stock; and so the trading cycle continues.

140. I have drawn attention to Slade J's reference to an "unrestricted" right to deal with the proceeds of collected debts. It is clear that not every restriction on a trader's freedom of action is a badge of a fixed charge: see *Brightlife* [1987] Ch 200, 209. A prohibition on factoring or otherwise dealing with uncollected debts does not prevent the trader from collecting the debts itself. But if the terms of the debenture were such as to require the trader to pay all its collected debts into the bank and to prohibit the trader from drawing on the account (so that the account is blocked), a charge on debts, described as a fixed or specific charge, would indeed take effect as such (see *Re Keenan Brothers Ltd* [1986] BCLC 242, a decision of the Supreme Court of Ireland, followed by Morritt J in *William Gaskell Group Ltd v Highley* [1994] 1 BCLC 197). In those circumstances the chargee would be in control, prior to crystallisation, and the trader would be unable to trade in the ordinary way without the chargee's positive concurrence. In *Agnew*, Lord Millett pointed out ([2001] 2 AC 710, 730, para 48) that it was not enough to

provide in the debenture for an account to be blocked, if it was not in fact operated as a blocked account.

141. Both sides agree that the label of "fixed" or "specific" (which I take to be synonymous in this context) cannot be decisive if the rights created by the debenture, properly construed, are inconsistent with that label. There is a fairly close parallel (first drawn, I think, by Hoffmann J in *Brightlife* [1987] Ch 200, 209 and often repeated) with the important distinction, in land law, between a lease and a licence: see the decision of this House in *Street v Mountford* [1985] AC 809. The distinction is clear in principle although landlords (in framing letting agreements) and banks (in framing debentures) may produce legal documents in a form which makes the principle difficult to apply. Whether or not it is appropriate to describe this by some disparaging term such as camouflage, it is the court's duty to characterise the document according to the true legal effect of its terms, as has been very clearly explained by Lord Millett in *Agnew* [2001] 2 AC 710, 725-726, para 32. In each case there is a public interest which overrides unrestrained freedom of contract. On the lease/licence issue, the public interest is the protection of vulnerable people seeking living accommodation. On the fixed/floating issue, it is ensuring that preferential creditors obtain the measure of protection which Parliament intended them to have. This public interest is unaffected by the changes in the classes of preferential creditors made by section 251 of the Enterprise Act 2002.

142. In my opinion Slade J did not, in *Siebe Gorman*, make any significant error in stating the general principles which apply. But he did not correctly construe the debenture which was before him in that case, and his decision on its construction has had surprisingly far-reaching consequences.

Siebe Gorman & Co Ltd v Barclays Bank Ltd

143. In his submissions on *Siebe Gorman*, Mr Moss QC mentioned that the judgment of Slade J was given after an eight-day trial. So it was, but that fact cannot by itself add weight to its authority. Only two pages of a 25 page judgment are directly concerned with whether the charge on McDonald's debts, although expressed in the debenture as a fixed charge, amounted in law to a floating charge. Slade J also had to resolve many disputed issues of fact, which were complicated by the death, before trial, of a key witness. He had to consider issues of

estoppel and rectification (though he did not ultimately have to decide those issues.) He did have to decide a difficult issue as to priority of charges (and his judgment on that issue may be the main reason why the judgment was reported). Of the 17 authorities cited, only three appear to have been cited on the issue of characterisation of the charge.

144. The key passage in the judgment of Slade J, at pp158-159, is set out in full in the judgment of the Master of the Rolls in this case, [2004] Ch 337, 376, para 72. I have already quoted part of it, with which the Crown has little or no quarrel. The crucial passage which the Crown does criticise is as follows (at p159):

> "I see no reason why the court should not give effect to the intention of the parties, as stated in clause 3 (d), that the charge should be a first fixed charge on book debts. I do not accept the argument that the provisions of clause 5 (c) negative the existence of a specific charge. All that they do, in my judgment, is to reinforce the specific charge given by clause 3. The mere fact that there may exist certain forms of dealing with book debts which are not specifically prohibited by clause 5 (c) does not in my judgment turn the specific charge into a floating charge.
>
> This conclusion that the charge is a specific charge involves the further conclusion that, during the continuance of the security, the bank would have the right, if it chose, to assert its lien under the charge on the proceeds of the book debts, even at a time when the particular account into which they were paid was temporarily in credit."

145. Mr Briggs QC, for the Crown, submitted that Slade J was wrong about the significance of clause 5 (c) of the debenture, which provided that during the continuance of the security McDonald

> "shall pay into the company's account with the bank all monies which it may receive in respect of the book debts and other debts hereby charged and shall not without the prior consent of the bank in writing, purport to charge or assign the same in favour of any other person and shall if called upon to do so by the bank execute a legal assignment of such book debts and other debts to the bank."

The judge saw this as reinforcing the specific charge given by clause 3 (that is, the "label"). Its real significance, in my opinion, was that it did not in any way restrict McDonald from taking the most natural course for a trader in the ordinary way of business, that is collecting the debts and paying them into its current account with the chargee bank. I agree with the criticism by Alan Berg, "Charges over Book Debts: a Reply" [1995] JBL 433, 445 that the judge's construction was based too much on linguistic considerations, in isolation from the matrix of facts in which the security was created.

146. When the debenture was granted, McDonald had a single current account which was overdrawn at the outset, with an overdraft limit (see [1979] 2 Lloyd's Rep 142, 146-7 summarised in paras 62 and 63 of the judgment of the Master of the Rolls). It is the proper characterisation of a charge at the time of its creation that is important, and the various manoeuvres which took place in the last few weeks before McDonald's final collapse (summarised in paras 65-69 of the Master of the Rolls' judgment) cannot be relevant to the issue of characterisation. For at least a year after the grant of the debenture, McDonald was free to use its overdraft facility to recycle its book debts in the ordinary course of its business. Slade J seems, with great respect, to have overlooked that that was the crucial point. The bank could decide to intervene and alter the banker-customer relationship. Indeed it did so by blocking McDonald's account about seven weeks before it learned of the winding-up petition. But under the charge~~s~~ as created there was no such restriction, either in clause 5 (c) or elsewhere. The last sentence of the criticised passage which I have set out above (beginning "This conclusion that the charge is a specific charge involves the further conclusion that . . .") was not, as its language makes perfectly clear, reinforcing the first conclusion with a second line of reasoning. It was drawing a further (incorrect) conclusion from the first (incorrect) conclusion.

Later authority

147. Like the Vice-Chancellor ([2004] Ch 337, 355, para 39) I feel the greatest hesitation and reluctance in disagreeing with a decision of Slade J. Indeed, the very high respect in which his judgments have always been held must have contributed to the enduring influence which *Siebe Gorman* has had. In their printed case Mr Moss and Mr Goldring assert that *Siebe Gorman* has been approved or accepted in many subsequent cases, and in England has not (until the Vice-Chancellor's decision) been held to be wrongly decided, or regarded as limited to its own facts.

148. That is very largely correct, although I do detect some inclination on the part of experienced Chancery judges to treat the decision as turning on a particular (and not fully explained) point of construction. That is my reading of Hoffmann J's observations in *Brightlife* [1987] Ch 200, 210 and of Lord Millett's observations in *Agnew* [2001] 2 AC 710, 727, para 38. In *In re Portbase Clothing Ltd* [1993] Ch 388, 396, Chadwick J made clear that he did not have to consider, and was not considering, whether *Siebe Gorman* was rightly decided. In the only English case in which *Siebe Gorman* was directly challenged, *In re A Company (No. 005009 of 1987) Ex p Copp* [1989] BCLC 13, the grounds of challenge were curiously oblique, no doubt in recognition of the fact that a first-instance Chancery judge would be very inclined to follow Slade J (as Knox J did) unless some point of distinction could be established.

149. In New Zealand *Siebe Gorman* has not been followed at first instance (the Court of Appeal of New Zealand found it unnecessary to decide this point): *Hoverd Industries Ltd v Supercool Refrigeration & Air Conditioning (1991) Ltd* [1994] 3 NZLR 300; [1995] 3 NZLR 577. In relation to a debenture in the *Siebe Gorman* form Tompkins J stated ([1994] 3 NZLR 300, 321):

> "It is my conclusion that a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the bank. It does not, without more, fasten the charge onto those proceeds. Supercool was free to deal with those proceeds except in the two respects stated, unless and until the BNZ intervened in a manner that would effectively inhibit that freedom."

I consider that that would be a correct statement of the position under English law.

150. A debenture in the *Siebe Gorman* form has also been considered by the Supreme Court of Ireland in *Re Holidair Ltd* [1994] 1 ILRM 481. *Siebe Gorman* was not cited. But the reasoning of Blaney J (with whom three other members of the court agreed) is compelling (at p493):

> "I am satisfied, accordingly, that the correct construction of the clause is that the trustee had a discretion to determine into what company account with what bank the proceeds of book debts should be paid from time to time. But there is no restriction in the clause on the companies drawing the monies out of these accounts. Accordingly, there is nothing in it to prevent the companies from using the proceeds of the book debts in the normal way for the purpose of carrying on their business. By reason of this the charge has also the third characteristic referred to by Romer LJ in his judgment in the case of *In re Yorkshire Woolcombers' Association Ltd* and is accordingly a floating charge and not a fixed charge."

151. In *In re New Bullas Trading Ltd* [1994] 1 BCLC 485, the Court of Appeal, differing from Knox J ([1993] BCLC 1389) upheld as a fixed charge a charge expressed as a fixed charge on book debts until they were collected, coupled with the requirement for them to be paid into a specified bank account (the chargee was not itself a bank) and a floating charge on the proceeds in the bank account. This decision was not followed by the Court of Appeal of New Zealand in *Commissioner of Income Tax v Agnew* [2001] 1 NZLR 223 (the headnote is mistaken in referring to the decision of the Court of Appeal in *New Bullas* as having been adopted; it was either distinguished or left in the air). *Agnew* then came on appeal to the Privy Council [2001] 2 AC 710, which upheld the Court of Appeal of New Zealand and in doing so strongly disapproved of *New Bullas*. Mr Moss has not sought to defend *New Bullas* and it may not be strictly necessary for your Lordships to express any view about it. But for my part I am sure that the Privy Council was correct in *Agnew*, and this House has already gone some way to approving *Agnew* in *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2002] 1 AC 336, 352. The essential fallacy in *New Bullas* has been explained by Professor Worthington in a note, "Fixed Charges Over Book Debts and Other Receivables" (1997) 113 LQR 562:

> "The categorisation of a charge over receivables requires examination of the permitted dealings with collected proceeds *only* in order to clarify whether the chargor is free to deal with the charged asset itself (the receivable) in the ordinary course of business without the consent of the chargee. This, and nothing else, is the hallmark of a floating charge."

The judgments below

152. Having covered most of the ground already I can set out quite shortly my views on the judgments of Sir Andrew Morritt V-C and the Court of Appeal [2004] Ch 337. The Vice-Chancellor held that *Siebe Gorman* was indistinguishable but wrongly decided. The Court of Appeal (Lord Phillips of Worth Matravers MR, Jonathan Parker and Jacobs LJJ) reversed the Vice-Chancellor in a single judgment of the Master of the Rolls with which the other members of the court agreed.

153. In my respectful opinion the Vice-Chancellor was correct on every point in his judgment except one, which does not present any obstacle to your Lordships (that is as to the relative authority as precedents of *New Bullas* and *Agnew*). On every point of substance I agree with the Vice-Chancellor's analysis and conclusions. In particular, I agree with his reasons for holding that *Siebe Gorman* was not distinguishable (p 347, paras 15 and 16):

> "Counsel for the bank points out that the observations of Slade J were directed to an account which was in credit. By contrast in this case the account was when opened and at all times thereafter in debit. He submits that the payment of the proceeds of a book debt into an overdrawn bank account prevents its further identification or tracing through such debit balance so that it cannot be contended that the company thereby enjoyed an unrestricted use of that book debt or of those proceeds. It is convenient to deal with this point at this stage.
>
> I do not think that any distinction is to be drawn for this purpose between the operation of an account which is in credit and the operation of one which is in debit but within the overdraft facilities agreed with the bank. The question is not whether the subsequent drawings by the company can be traced to or identified as the proceeds of a previous book debt but whether the charge when created contemplated that the company should continue to trade and should until the occurrence of some specified future event be free to use in such trade the class of asset described as book debts."

The Vice-Chancellor then referred to the classic statements in the *Yorkshire Woolcombers* case [1903] 2 Ch 284, 289 and *Illingworth v Houldsworth* [1904] AC 355, 357-358.

154. I also agree with the Vice-Chancellor's reasons for declining to follow *Siebe Gorman*. He referred to the critical passage in Slade J's judgment (which I have already set out) and observed (p 355, para 39):

> "But, as indicated in *Agnew's* case, the real question was whether the rights and obligations conferred and imposed by clause 5(c) disclosed an intention that the company should be free to deal with the book debts and withdraw them from the security without the consent of the bank. Such an approach to the provisions of clause 5 (c) of the debenture in the *Siebe Gorman* case must have led to the conclusion that the collection and free use of the proceeds of book debts through the ordinary operation of the bank account was not only permitted but envisaged. The inevitable consequence would be to reject the description of the transaction as a first fixed charge."

155. It follows that the Court of Appeal, although right on the doctrine of precedent, was in my view wrong to reverse the Vice-Chancellor on the issue of substance. I respectfully think that the Master of the Rolls was wrong in the broad ground of decision which he put forward at p 383, para 94 of his judgment. It has the attraction of simplicity and certainty but it approaches an essentially practical question (can the trader continue to use his circulating capital, including any credit available under an agreed overdraft, in the ordinary course of his business?) as if it were a technical question of tracing in equity. The Vice-Chancellor was right to reject that approach, as he did in the first passage which I have quoted from his judgment. I also think that the Master of the Rolls was wrong on the narrower issue of construction which he considered a little earlier in his judgment (p 382, para 93). I need not repeat my reasons for that conclusion.

Postcript: draftsmen's precedents and collateral transactions

156. Judges considering this area of the law have often commented on the convenience (in point of legal certainty) of using standard-form

clauses, the meaning of which has already been determined by the court. For instance Knox J observed in *Ex p Copp* [1989] BCLC 13, 25:

> "this is a type of transaction in respect of which judicial precedent is a particularly valuable guide to the commercial adviser. It is one of the main justifications for the doctrine of precedent that the adviser can, if he can rely on precedent, give reliable advice to his clients, and it is trite law that that is a particularly cogent consideration in regard to property transactions of one sort or another."

Requirements for particulars of floating charges to be registered publicly, and for a company's register of debentures to be open for inspection, suggest that Parliament intended that the existence and scope of any floating charge should be ascertainable by the general public, at least in theory (doubts as to how the system works in practice were expressed by Lord Hoffmann in the *Cosslett* case, [2002] 1 AC 336, 347-8, para 19).

157. These considerations might be thought to lead to the conclusion that everything relevant to the characterisation of a charge should be apparent on the face of the formal debenture, without further inquiry. That was, as I understand it, one of the reasons why Knox J, in *Ex p Copp*, declined to look at evidence about an agreed overdraft limit, regarding it as a "collateral arrangement". Knox J may have been right in his view that it was unnecessary to receive evidence about an overdraft limit (which may change from time to time) but he took the wrong approach as to the effect of the debenture itself, as the Vice-Chancellor rightly concluded ([2004] Ch 337, 355, para 40). The form of debenture showed that the recycling of book debts was "not only permitted but envisaged" and it contained no relevant restriction on that being done in the ordinary course of business.

158. In practice banks use printed standard forms of debenture in simple cases, and City solicitors no doubt have more sophisticated forms, suitable for very large transactions, in their word-processing libraries. It is most desirable that any form of secured debenture, whether simple or complicated, should contain all the terms necessary for its correct characterisation, without resort to any side-letters or other less formal documents (as in the Australian case of *Hart v Barnes* (1982) 7 ACLR 310, mentioned in *Agnew* at para 23). But the fact is that when a bank takes a charge there will normally be at least three

documents in play: the debenture creating the charge, the bank's facility letter offering a term loan or an overdraft, and the bank's general terms and conditions. Sometimes there will be more documents that are relevant. I would not rule out the possibility that in some (probably rare) cases all this documentation might have to be taken into account, in its proper commercial context, in determining whether a charge "as created" was a fixed or floating charge.

159. In one of the earliest cases on floating charges, *In re Florence Land and Public Works Co* (1878) 10 Ch D530, 537, Sir George Jessel MR said,

> "The question we have to decide must be decided, like all other questions of the kind, having regard to the surrounding circumstances under which the instrument was executed, and especially the respective positions of the parties who were the contracting parties, to carry out whose agreement that instrument was executed."

Cozens-Hardy LJ made similar observations in *Yorkshire Woolcombers* [1903] 2 Ch 284, 297. Many of the later cases have emphasised the need for the court to look at the commercial realities of the situation. The wish to achieve legal certainty by use of a standard precedent cannot override the need to construe any document in its commercial context.

160. It is also necessary to bear in mind Lord Millett's warning in *Agnew* [2001] 2 AC 710, 730, para 48, that formal provision for a blocked account is not enough "if it is not operated as one in fact." Lord Millett did not expand on this point, which may raise difficult questions as to what Staughton LJ, in *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148, 186-7, referred to as "external" and "internal" routes to the construction of commercial documents. This point is discussed in an article by Stephen Atherton and Rizwaan Jameel Mokal in (2005) 26 Company Lawyer 10, 16-18. These difficulties suggest to me that the expedient mentioned in the postscript to the judgment of the Master of the Rolls (para 99), although no doubt appropriate and efficacious in some commercial contexts, may not provide a simple solution in every case.

161. On the topic of overruling long-standing decisions which have been relied on by commercial lenders, and on the further topic of prospective overruling, I am in full and respectful agreement with the opinions of my noble and learned friends, Lord Nicholls of Birkenhead and Lord Hope. I would allow this appeal and hold, without any sort of temporal restriction, that *Siebe Gorman* was wrongly decided on the issue of construction.

BARONESS HALE OF RICHMOND

My Lords,

162. I agree that, for the reasons given in the opinion of my noble and learned friend, Lord Scott of Foscote, supplemented by those of Lord Hope of Craighead and Lord Walker of Gestingthorpe, the debenture in this case created only a floating charge. I also agree that that part of the decision in *Siebe Gorman & Co Ltd v Barclay's Bank Ltd* [1979] 2 Lloyd's Rep 142 which dealt with the effect of the debenture in that case should be overruled with the usual retrospective effect. In common with my noble and learned friend, Lord Nicholls of Birkenhead, and also Lord Hope, I would not wish to rule out the possibility that this House might one day consider that the only just result was to declare that its decision should have prospective effect only, including the possibility that this could arise in a dispute about the interpretation of a statute.

163. There is one other possibility that I would not wish to rule out. That is whether it might in future be decided that the Court of Appeal, or even the High Court, could decline to follow a previous decision of the Court of Appeal which has been expressly disapproved as part of the *ratio decidendi* in a case in the Judicial Committee of Privy Council on appeal from a country in which the law on the subject is the same as that in England and Wales. The Court of Appeal in *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1972] 1 QB 210 decided that it was possible. In *Davis v Johnson* [1979] AC 264, this House stated that the rule laid down in *Young v Bristol Aeroplane Co Ltd* [1944] KB 718, that with only three exceptions the Court of Appeal is bound by its own previous decisions, was still binding on the Court of Appeal, despite what Lord Diplock described, at p 325C, as the 'one-man crusade' of Lord Denning to free them from its shackles. This was in the context of a much more radical departure from the exceptions allowed in the *Young* case. *Worcester Works Finance* was not cited or

referred to in either the House of Lords or the Court of Appeal in *Davis v Johnson*. Privy Council decisions were not discussed in *Young*. We ourselves have heard no argument on the matter. I would hope, therefore, that nothing which is said in this appeal is taken to rule out the possibility that a further exception or qualification might exist or be developed along the lines indicated above.

164. In common with your lordships, I would allow this appeal and make the order proposed by Lord Scott.

LORD BROWN OF EATON-UNDER-HEYWOOD

My Lords,

165. I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Nicholls of Birkenhead, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give I too would allow this appeal and make the order proposed by Lord Scott. Whilst I would not rule out the possibility that this House may one day think it right to declare the law with prospective effect only, I am quite clear that this is not the case for such an order.

HOUSE OF LORDS

OPINIONS OF THE LORDS OF APPEAL FOR JUDGMENT IN THE CAUSE

National Westminster Bank plc (Respondents) *v.* Spectrum Plus Limited and others and others (Appellants)

[2005] UKHL 41

LORD NICHOLLS OF BIRKENHEAD

My Lords,

1. I have had the advantage of reading in draft the opinions of my noble and learned friends Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give I agree that the decision of Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 was wrong and should be overruled.

2. The respondent bank had a second string to its bow. The bank contended that if the House considered *Siebe Gorman* was wrongly decided the House should overrule that decision only for the future. The bank submitted that the *Siebe Gorman* decision should continue to apply to all transactions entered into before your Lordships' decision in the present case, including the debenture under consideration on this appeal.

3. This submission raises a controversial issue of major importance concerning the power of your Lordships' House to give a ruling in this 'prospective only' form. The bank argued the House has this power. The Crown appellants were content to assume the House may have this power. At very short notice the Attorney General, on the invitation of your Lordships, appointed Mr Glick QC to assist the House by presenting the case against the House having any such jurisdiction. The House is indebted to Mr Glick, who was assisted by Mr Edmund Nourse, for his clear and comprehensive presentation of this case.

Prospective overruling

4. The starting point is to note some basic, indeed elementary, features of this country's judicial system. The first concerns the essential role of courts of law. In the ordinary course the function of a court is adjudicative. Courts decide the legal consequences of past happenings. Courts make findings on disputed questions of fact, identify and apply the relevant law to the facts agreed by the parties or found by the court, and award appropriate remedies.

5. The second feature concerns the wider effect of a court decision on a point of law. To promote a desirable degree of consistency and certainty about the present state of 'the law', courts in this country have long adopted the practice of treating decisions on a point of law as precedents for the future. If the same point of law arises in another case at a later date a court will treat a previous decision as binding or persuasive, depending upon the well-known hierarchical principles of 'stare decisis'.

6. The third feature is that from time to time court decisions on points of law represent a change in what until then the law in question was generally thought to be. This happens most obviously when a court departs from, or an appellate court overrules, a previous decision on the same point of law. The point of law may concern the interpretation of a statute or it may relate to a principle of 'judge-made' law, that is, the common law (which for this purpose includes equity). A change of this nature does not always involve departing from or overruling a previous court decision. Sometimes a court may give a statute, until then free from judicial interpretation, a different meaning from that commonly held.

7. The fourth feature is a consequence of the second and third features. A court ruling which changes the law from what it was previously thought to be operates retrospectively as well as prospectively. The ruling will have a retrospective effect so far as the parties to the particular dispute are concerned, as occurred with the manufacturer of the ginger beer in *Donoghue v Stevenson* [1932] AC 562. When Mr Stevenson manufactured and bottled and sold his ginger beer the law on manufacturers' liability as generally understood may have been as stated by the majority of the Second Division of the Court of Session and the minority of their Lordships in that case. But in the claim Ms Donoghue brought against Mr Stevenson his legal obligations

fell to be decided in accordance with Lord Atkin's famous statements. Further, because of the doctrine of precedent the same would be true of everyone else whose case thereafter came before a court. Their rights and obligations would be decided according to the law as enunciated by the majority of the House of Lords in that case even though the relevant events occurred before that decision was given.

8. People generally conduct their affairs on the basis of what they understand the law to be. This 'retrospective' effect of a change in the law of this nature can have disruptive and seemingly unfair consequences. 'Prospective overruling', sometimes described as 'non-retroactive overruling', is a judicial tool fashioned to mitigate these adverse consequences. It is a shorthand description for court rulings on points of law which, to greater or lesser extent, are designed not to have the normal retrospective effect of judicial decisions.

9. Prospective overruling takes several different forms. In its simplest form prospective overruling involves a court giving a ruling of the character sought by the bank in the present case. Overruling of this simple or 'pure' type has the effect that the court ruling has an exclusively prospective effect. The ruling applies only to transactions or happenings occurring after the date of the court decision. All transactions entered into, or events occurring, before that date continue to be governed by the law as it was conceived to be before the court gave its ruling.

10. Other forms of prospective overruling are more limited and 'selective' in their departure from the normal effect of court decisions. The ruling in its operation may be prospective and, additionally, retrospective in its effect as between the parties to the case in which the ruling is given. Or the ruling may be prospective and, additionally, retrospective as between the parties in the case in which the ruling was given and also as between the parties in any other cases already pending before the courts. There are other variations on the same theme.

11. Recently Advocate General Jacobs suggested an even more radical form of prospective overruling. He suggested that the retrospective *and prospective* effect of a ruling of the European Court of Justice might be subject to a temporal limitation that the ruling should not take effect until a future date, namely, when the State had had a reasonable opportunity to introduce new legislation: *Banco Popolare di*

Cremona v Agenzia Entrate Ufffficio Cremona (Case C-475/03, 17 March 2005), paras 72-88.

United Kingdom practice

12. Prospective overruling has not yet been adopted as a practice in this country. The traditional approach was stated crisply by Lord Reid in *West Midland Baptist (Trust) Association Inc v Birmingham Corporation* [1970] AC 874, 898-899, a case concerning compulsory acquisition:

> 'We cannot say that the law was one thing yesterday but is to be something different tomorrow. If we decide that [the existing rule] is wrong we must decide that it always has been wrong, and that would mean that in many completed transactions owners have received too little compensation. But that often happens when an existing decision is reversed.'

13. In *Launchbury v Morgans* [1973] AC 127, 137, Lord Wilberforce noted 'We cannot, without yet further innovation, change the law prospectively only'. More recently, in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 379, Lord Goff of Chieveley said the system of prospective overruling 'has no place in our legal system'.

14. The possibility of a change in this practice has been raised from time to time. In *R v National Insurance Commissioner, Ex p Hudson* [1972] AC 944, 1015, 1026, Lord Diplock said this topic deserved consideration. Lord Simon of Glaisdale said the possibility of prospective overruling should be seriously considered. He expressed a preference for legislation, saying that 'informed professional opinion' was probably to the effect that the House had no power to overrule decisions with prospective effect only. Lord Simon repeated his plea in *Milliangos v George Frank (Textiles) Ltd* [1976] AC 443, 490. In the Court of Appeal in *R v Governor of Brockhill Prison, Ex p Evans (No 2)* [1999] QB 1043, 1058, Lord Woolf MR expressed the view that prospective overruling has much to commend it. In your Lordships' House this issue was left open: [2001] 2 AC 19. Lord Slynn of Hadley, with his Luxembourg experience in mind, considered there may be situations in which it would be desirable, and in no way unjust, that the effect of judicial rulings should be prospective or limited to certain

claimants: page 26. Lord Hobhouse of Woodborough was hostile to prospective overruling, describing it as a denial of the constitutional role of the courts: page 48. In the advocates' immunity case of *Arthur J S Hall & Co v Simons* [2002] 1 AC 615 the House departed from the earlier decision of the House in *Rondel v Worsley* [1969] 1 AC 191. The decision on the immunity point in the *Hall* case did not affect the actual outcome in that case. In that context my noble and learned friend Lord Hope of Craighead expressed the view that the change in the law made by the *Hall* decision should take effect only from the date of the judgment in that case: page 726. He said, at page 710:

> 'I consider it to be a legitimate exercise of your Lordships' judicial function to declare prospectively whether or not the immunity – which is a judge-made rule – is to be available in the future and, if so, in what circumstances.'

15. Perhaps the nearest the House has come to giving non-retroactive rulings was in two decisions on the law of undue influence. The decisions concerned cases where, typically, a wife claims her consent to a mortgage of her share in a jointly-owned home was procured by her husband exercising undue influence over her: *Barclays Bank Plc v O'Brien* [1994] 1 AC 180 and *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773. In both cases the House said that, in order to avoid being fixed with constructive notice of the wife's rights, a bank could reasonably be expected to bring home to the wife the risks she was running. But in both cases the House sought to give guidance by being more specific on what that test meant in practice. It was in this limited respect that in both cases the House, having regard to realities, drew a distinction between past and future transactions. In the *O'Brien* case, at pages 196-197, Lord Browne-Wilkinson said that whether the steps taken by the creditor satisfied the prescribed test would, for past transactions, depend on the facts of each case. As to the future, an appropriately worded warning given at a private meeting between the creditor and the wife would generally suffice to satisfy the test. Despite this admonition the banks did not adopt the course of holding such a meeting. In the *Etridge* case the House decided that holding a private meeting was not the only way a bank could discharge its obligation to bring home to the wife the risks she was running. I set out, at pages 811-812, paras 79-80, other steps which would generally be regarded as discharging this obligation as to future transactions and, separately, as to past transactions.

16. These two decisions illustrate the flexibility inherent in this country's legal system. In passing, another instance of this flexibility can be noted. This illustrates how the House has been prepared to depart from a strict and narrow interpretation of the judiciary's adjudicative role. From time to time situations occur where a point of law of general importance is raised by court proceedings but the outcome will have no practical effect in the particular case. The general principle is that the court will not entertain such proceedings. Nevertheless, when there is good reason for doing so, the House, in the cautious exercise of its discretion, may proceed to decide the point of law. A recent example occurred in the Judicial Committee of the Privy Council in *Attorney General for Jersey v Holley* [2005] UKPC 23. There an enlarged Board resolved a conflict between previous decisions of the Board and the House of Lords on an important issue concerning the defence of provocation to a charge of murder. The Board decided this point even though the outcome, either way, would have no effect on the conviction or sentence of the defendant in that case.

17. One further matter may be noted regarding the present position on prospective overruling. In the devolution legislation of 1998 Parliament made express provision for courts to have power to limit the temporal effect of a particular class of decisions. The Scotland Act 1998, section 102, provides that where a court decides a provision in an Act of the Scottish Parliament is not within the legislative competence of the Parliament the court may make an order removing or limiting any retrospective effect of the decision or suspending the effect of the decision to enable the defect to be corrected. Comparable provisions appear in the Government of Wales Act 1998, section 110, and the Northern Ireland Act 1998, section 81. These provisions show that Parliament does not perceive non-retroactive rulings by courts as being of their nature inconsistent with the judiciary's proper function.

Overseas experience

18. In other common law countries prospective overruling has taken root as such only in the United States of America and India. In the United States the fortunes of prospective overruling, sometimes known colloquially as 'Sunbursting', have waxed and waned. Prospective overruling, although without that label, occurred as long ago as the mid-19th century in the Ohio case of *Bingham v Miller* (1848) 17 Ohio 45. In 1932 the Supreme Court, in a famous judgment of Justice Cardozo, held that the Constitution neither prohibits nor requires prospective overruling. The Federal Court, he said, 'has no voice upon the subject':

see *Great Northern Railway Co v Sunburst Oil & Refining Co* 287 US 358. Prospective overruling by the Supreme Court itself reached its apogee in the 1960s and 1970s when the court decided that in both criminal and civil cases 'the accepted rule today is that in appropriate cases the Court may in the interests of justice make the rule prospective': *Linkletter v Walker* (1965) 381 US 618, 628. In 1971 in the leading case of *Chevron Oil Co v Huson* (1971) 404 US 97, 106-107, the court summarised three factors taken into account when considering if a decision should be applied non-retroactively: whether the decision established a new principle of law, whether retrospective operation would advance or retard the operation of the new rule, and whether the decision could produce substantial inequitable results if applied retrospectively.

19. Since then the Supreme Court has retreated. In *Griffith v Kentucky* (1987) 107 S Ct 708 the court abandoned prospective overruling when directly reviewing criminal cases. Selective overruling has been abandoned in civil cases: *James B Beam Distilling Co v Georgia* (1991) 501 US 529 and *Harper v Virginia Department of Taxation* (1992) 509 US 86. Whether the court has abandoned 'pure' prospective overruling in civil cases remains to be resolved: see *Glazner v Glazner* (2003) 347 F 3d 1212, a decision of the Court of Appeals of the Eleventh Circuit.

20. Taking its lead from the United States jurisprudence the Supreme Court of India has made prospective overrulings but only in constitutional cases. The first case was *Golak Nath v State of Punjab* (1967) 2 SCJ 762. In that case the court reversed two earlier decisions of its own in circumstances where meanwhile constitutional amendments had been made, and state laws enacted, on the basis of the court's earlier two decisions. The jurisdiction is not confined to cases where an earlier decision is overruled. Non-retroactive effect may be given to a ruling which decides an issue for the first time: *India Cement Ltd v State of Tamil Nadu* (1990) 1 SCC 12. The Supreme Court founds its jurisdiction to make rulings of this character on article 142 of the Indian Constitution. This article empowers the Supreme Court to 'make such order as is necessary for doing complete justice in any cause or matter pending before it'. In exercise of this power it is a 'well settled proposition that it is open to the Court to grant, mould or restrict relief in a manner most appropriate to the situation before it, in such a way as to advance the interests of justice': *Orissa Cement Ltd v State of Orissa* 1991 Supp (1) SCC 430.

21. In Ireland in *Murphy v Attorney General* [1982] IR 241 the Supreme Court held that certain taxation provisions were unconstitutional and void. The court rejected an argument that it was for the courts to say whether these statutory provisions should be held to be invalid prospectively or with only limited retrospective effect. The provisions were invalid from the date on which they were enacted. However, the court also held that the plaintiffs' restitutionary right to recover amounts paid by way of taxes unconstitutionally imposed began with the first year in which they raised their objections. Further, unless other taxpayers had already made tax recovery claims, only the plaintiffs could maintain a claim pursuant to the court's decision.

22. In Canada prospective overruling has not found favour. In *Re Edward and Edward* (1987) 39 DLR (4th) 654 the Saskatchewan Court of Appeal said prospective overruling would be a 'dramatic deviation from the norm in both Canada and England'. Bayda CJS, at page 664, said 'the most cogent reason for rejecting this technique is the necessity for our courts to maintain their independent, neutral and non-legislative role'. He approved comments that prospective overruling 'would distort our expectations of the judicial role' and that 'confidence may recede at the point where the courts are not seen as adjudicative agencies but as legislators': see Lord Lloyd of Hampstead, 'Introduction to Jurisprudence', 4th ed, (1979), pp 858-859. But in the extreme circumstances of a *Reference re Language Rights under the Manitoba Act 1870* (1985) 19 DLR (4th) 1 the Supreme Court of Canada declined to give retroactive effect to its decision on the constitutional invalidity of all statutes and regulations of the Province of Manitoba not printed and published in both English and French. A declaration that the unilingual laws of Manitoba were of no effect would have created a legal vacuum with consequent legal chaos. Refusing to take a narrow and literal approach to constitutional interpretation, the court held it could have regard to unwritten postulates such as the principle of the rule of law. Faced with the task of recognising the unconstitutionality of Manitoba's unilingual laws while avoiding a legal vacuum and ensuring the continuity of the rule of law, the court made a ruling which gave deemed temporary validity to all laws rendered invalid by reason of their unilingual defect.

Luxembourg and Strasbourg

23. Far-reaching economic consequences may flow from the retrospective effect of rulings by the European Court of Justice on the interpretation of Community instruments. This has led that court to

limit the temporal effect of some of its rulings, from *Defrenne v Sabena* [1976] ECR 455 onwards. Sitting as a Grand Chamber the court recently reiterated its basic approach in *R (Bidar) v Ealing London Borough Council* [2005] 2 WLR 1078, 1112, para 66:

> 'the interpretation the Court of Justice gives to a rule of Community law is limited to clarifying and defining the meaning and scope of that rule *as it ought to have been understood and applied from the time of its coming into force*. It follows that the rule as thus interpreted may, and must, be applied by the courts even to legal relationships arising and established before the judgment ruling on the request for interpretation ..' (emphasis added)

But the court noted that 'exceptionally' it may limit the temporal effect of a ruling. It has done so only in defined circumstances (paragraph 69):

> 'The court has taken that step only in quite specific circumstances, where there was a risk of serious economic repercussions owing in particular to the large number of legal relationships entered into in good faith on the basis of rules considered to be validly in force and where it appeared that both individuals and national authorities had been led into adopting practices which did not comply with Community legislation by reason of objective, significant uncertainty regarding the implications of Community provisions, to which the conduct of other member states or the Commission may even have contributed ...'

24. Unlike the European Court of Justice and its role in the interpretation of Community instruments, the European Court of Human Rights' interpretative function is not confined to identifying the meaning properly to be given to the European Convention on Human Rights when it first came into force. The Strasbourg court interprets the Convention in the light of present-day conditions: *Marckx v Belgium* (1979) 2 EHRR 330, 353, para 58. In that case, taking heed of the decision of the European Court of Justice in *Defrenne v Sabena* [1976] ECR 455, the Strasbourg court held that the principle of legal certainty dispensed the Belgian state from re-opening legal acts antedating the delivery of its judgment.

25. A notable instance of this 'dynamic and evolutive' approach to interpretation can be found in the successive cases relating to recognition of the rights of transsexual persons, culminating in the decision in *Goodwin v United Kingdom* (2002) 35 EHRR 447. In *Goodwin* the court held that the United Kingdom could 'no longer claim' that the matter fell within its margin of appreciation and that the fair balance inherent in the Convention 'now' tilted in favour of the applicant: para 93. Running through the court's reasoning is an acceptance that the earlier, contrary decisions of the court remained correct statements of the interpretation and application of the Convention when they were given. Consistently with this the court held that the finding of violation 'with the consequences which will ensue for the future' was just satisfaction: para 120.

Practical difficulties

26. As with all controversial subjects prospective overruling attracts arguments both ways. The arguments against prospective overruling are both principled and practical. It will be convenient to note first the major practical difficulties attendant upon prospective overruling. The retrospective nature of a court ruling on a point of law means that the ruling applies in all cases, past as well as future. This is subject only to defences of general application, such as limitation, laches, and res judicata. Whatever its faults the retrospective application of court rulings is straightforward. Prospective overruling creates problems of discrimination. Born out of a laudable wish to mitigate the seeming unfairness of a retrospective change in the law, prospective overruling can beget unfairness of its own.

27. This is most marked in criminal cases, where 'pure' prospective overruling would leave a successful defendant languishing in prison. 'Selective' prospective overruling avoids this consequence but it could see a successful defendant freed while others in like case stayed in prison. In civil cases 'pure' prospective overruling would hinder the development of the law by discouraging claimants from challenging a prevailing view of the law. 'Selective' overruling, if only the successful claimant benefits from the change, is likely to mean that persons in like case are treated differently. Further, it would introduce an arbitrary element into the law. The ability to obtain an effective remedy could depend upon which of several challenges reaches the House of Lords first. Even if everyone who had already commenced proceedings was given the benefit of the court ruling there would still be scope for discrimination: there would be discrimination between those who knew

they might have a claim and started proceeding post-haste and those, lacking proper advice, who were unaware they might have a claim.

Objections in principle

28. The essence of the principled argument against prospective overruling is that in this country prospective overruling is outside the constitutional limits of the judicial function. It would amount to the judicial usurpation of the legislative function. Power to make rulings having only prospective effect, it is said, is not inherent in the judicial role. A ruling having only prospective effect cannot be characterised as merely a less extensive form of overruling than overruling with both retrospective and prospective effect. Prospective overruling robs a ruling of its essential authenticity as a judicial act. Courts exist to decide the legal consequences of past events. A court decision which takes the form of a 'pure' prospective overruling does not decide the dispute between the parties according to what the court declares is the present state of the law. With a ruling of this character the court gives a binding ruling on a point of law but then does not apply the law as thus declared to the parties to the dispute before the court. The effect of a prospective overruling of this character is that, on the disputed point of law, the court determines the rights and wrongs of the parties in accordance with an answer which it declares is no longer a correct statement of the law. Making such a ruling would not be a proper exercise of judicial power in this country. Making new law in this fashion gives a judge too much the appearance of a legislator. Legislation is a matter for Parliament, not judges.

29. In short, this argument raises this issue: would a decision by this House on a point of law having only prospective effect be so substantial a departure from established judicial procedure that it should be regarded as outside the function discharged by the judiciary under this country's constitution?

30. In answering this question the Appellate Jurisdiction Act 1876 (39 & 40 Vict, c 59) provides no assistance. The appellate jurisdiction of the House is formally regulated by this Act. Section 4 provides that appeals shall be brought by petition to the House praying that the order appealed may be reviewed 'before Her Majesty the Queen in her Court of Parliament' in order that this court 'may determine what of right, and according to the law and custom of this realm, ought to be done in the subject-matter of such appeal'. When Part III of the Constitutional

Reform Act 2005 comes into force the new Supreme Court will have power 'to determine any question necessary to be determined for the purposes of doing justice in an appeal to it': section 40(5). These general statements do not point either way on the issue now under consideration.

31. The next point to note is that, broadly stated, the constitutional separation of power between the legislature and the judiciary in this country is that the legislature makes the law, the courts administer the law. Parliament makes new law, by enacting statutes having prospective and varying degrees of retrospective effect: see *Wilson v First County Trust Ltd (No 2)* [2004] 1 AC 816, 831-832, para 19. When disputes arise, whether between citizens or between a citizen and the government, they are to be resolved in accordance with the law, and that is a matter for the judicial arm of the state. In this regard it is for the judiciary to decide what is the law, not the legislature or the executive.

32. This broad generalisation is a good starting point but, like most constitutional generalisations in this country, it calls for qualification. The boundary between making and administering the law is not in all respects quite so clear-cut as this general statement suggests. Contrary to the broad generalisation and within strict bounds, judges themselves have a legitimate law-making function. It is a function they have long exercised. In common law countries much of the basic law is still the common law. The common law is judge-made law. For centuries judges have been charged with the responsibility of keeping this law abreast of current social conditions and expectations. That is still the position. Continuing but limited development of the common law in this fashion is an integral part of the constitutional function of the judiciary. Had the judges not discharged this responsibility the common law would be the same now as it was in the reign of King Henry II. It is because of this that 'the common law is a living system of law, reacting to new events and new ideas, and so capable of providing the citizens of this country with a system of practical justice relevant to the times in which they live': see Lord Goff of Chieveley in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 377.

33. Changes in the common law made by judges are usually described as 'development' of the common law. This is a helpful description, not a misleading euphemism. Judges do not have a free hand to change the common law. Judicial development of the common law comprises the reasoned application of established common law principles, of greater or less generality, in current social conditions.

Development of the common law by the judges in any one case is usually marginal. Occasionally it is more far-reaching, as in *Donoghue v Stevenson* [1932] AC 562. In all cases development of the common law, as a response to changed conditions, does not come like a bolt out of a clear sky. Invariably the clouds gather first, often from different quarters, indicating with increasing obviousness what is coming. Justice Cardozo's colourful summary, in his 'The Nature of the Judicial Process' (1921), p 141, merits repetition:

> 'The judge, even when he is free, is still not wholly free. He is not to innovate at pleasure. He is not a knight-errant, roaming at will in pursuit of his own ideal of beauty or of goodness. He is to draw his inspiration from consecrated principles. He is not to yield to spasmodic sentiment, to vague and unregulated benevolence. He is to exercise a discretion informed by tradition, methodized by analogy, disciplined by system, and subordinated to "the primordial necessity of order in the social life"'.

34. At one time the judicial function of overruling previous common law decisions was sought to be rationalised by the 'declaratory' theory. Sir William Blackstone said that 'if it be found that the former decision is manifestly absurd or unjust, it is declared not that such a sentence was *bad law*, but that it was *not law*': 'Commentaries on the Laws of England' 1st ed, (1765), vol 1, p 70. If 'law' is given one of its several possible meanings, this theory is still valid when applied to cases where a previous decision is overruled as wrong when given. Most overruling occurs on this basis. These cases are to be contrasted with those where the later decision represents a response to changes in social conditions and expectations. Then, on any view, the declaratory approach is inapt. In this context this approach has long been discarded. It is at odds with reality.

35. For present purposes the distinction between these two types of cases is not important. Nor is the declaratory theory. For present purposes what matters is the practical impact overruling may have in both types of cases. The question now under consideration is whether, having regard to this practical impact, it is necessarily and always beyond the competence of the House as the supreme court in this country ever to limit the temporal effect of its ruling.

36. Before answering this question I must mention the judicial role in respect of statute law. Under section 4 of the Human Rights Act 1998 the court has an evaluative role in respect of primary legislation when considering whether to make a declaration of incompatibility. That apart, the essential function of the courts in respect of statutes is to apply and give effect to them. In cases of dispute the courts decide what, properly understood ('interpreted'), the legislation means. From time to time cases arise where changed social conditions dictate that a statutory provision should have a different and wider meaning than when enacted. *Fitzpatrick v Sterling Housing Association Ltd* [2001] 1 AC 27 is an instance of this. The House decided that by 1994 the long term homosexual partner of a Rent Act tenant was 'a member of the original tenant's family' even though that phrase would not have been so interpreted when the statutory provisions were first enacted in 1920. Such cases, arising out of changed circumstances, are exceptional.

37. There is another way courts can find themselves obliged to give a 'dynamic' interpretation to statutes. Section 3 of the Human Rights Act 1998 requires courts to read and give effect to legislation in a way which is compatible with Convention rights so far as it is possible to do so. When interpreting Convention rights courts must take into account decisions of the European Court of Human Rights: section 2(1). As already noted, that court gives an evolving interpretation to the principles embedded in the European Convention on Human Rights. Thus, indirectly, through changes in the interpretation and application of Convention rights, the courts of this country may find it necessary to give legislation a changed meaning.

38. Cases of these types are of increasing importance. But leaving these aside, the interpretation the court gives an Act of Parliament is the meaning which, in legal concept, the statute has borne from the very day it went onto the statute book. So, it is said, when your Lordships' House rules that a previous decision on the interpretation of a statutory provision was wrong, there is no question of the House changing the law. The House is doing no more than correct an error of interpretation. Thus, there should be no question of the House overruling the previous decision with prospective effect only. If the House were to take that course it would be sanctioning the continuing misapplication of the statute so far as existing transactions or past events are concerned. The House, it is said, has no power to do this. Statutes express the intention of Parliament. The courts must give effect to that intention from the date the legislation came into force. The House, acting in its judicial capacity, must give effect to the statute and it must do so in accordance with what it considers is the proper interpretation of the statute. The

House has no suspensive power in this regard. In *Ha v State of New South Wales* (1997) 189 CLR 465, 503-504, 515, the High Court of Australia unanimously considered 'it would be a perversion of judicial power to maintain in force that which is acknowledged not to be the law'. This would especially be so where 'non-compliance with a properly impugned statute exposes a person to criminal prosecution'.

Conclusion

39. The objections in principle and difficulties in practice mentioned above have substance, particularly in respect of the traditional interpretation of statutes. These objections are compelling pointers to what should be the normal reach of the judicial process. But, even in respect of statute law, they do not lead to the conclusion that prospective overruling can never be justified as a proper exercise of judicial power. In this country the established practice of judicial precedent derives from the common law. Constitutionally the judges have power to modify this practice.

40. Instances where this power has been used in courts elsewhere suggest there could be circumstances in this country where prospective overruling would be necessary to serve the underlying objective of the courts of this country: to administer justice fairly and in accordance with the law. There could be cases where a decision on an issue of law, whether common law or statute law, was unavoidable but the decision would have such gravely unfair and disruptive consequences for past transactions or happenings that this House would be compelled to depart from the normal principles relating to the retrospective and prospective effect of court decisions.

41. If, altogether exceptionally, the House as the country's supreme court were to follow this course I would not regard it as trespassing outside the functions properly to be discharged by the judiciary under this country's constitution. Rigidity in the operation of a legal system is a sign of weakness, not strength. It deprives a legal system of necessary elasticity. Far from achieving a constitutionally exemplary result, it can produce a legal system unable to function effectively in changing times. 'Never say never' is a wise judicial precept, in the interest of all citizens of the country.

42. Moreover, in one particular context the courts' ability to give a ruling having only prospective effect seems irresistible. As noted above, at times the Strasbourg court interprets and applies the European Convention on Human Rights with prospective effect only. It would be odd if in interpreting and applying Convention rights the House was not able to give rulings having a comparable limited temporal effect: see Lord Rodger of Earlsferry, 'A Time for Everything under the Law: Some Reflections on Retrospectivity', (2005) 121 LQR 57, 77.

43. I turn to the present case. In my view it is miles away from the exceptional category in which alone prospective overruling would be legitimate. No doubt over the years the clearing banks, including the respondent bank, have to some extent relied upon the *Siebe Gorman* decision when formulating and using their standard forms of charges on book debts. But banks and others who lend money on the security of charges on a company's undertaking are sophisticated operators. There is no reason to suppose this decision lulled them into a false sense of security. *Siebe Gorman* was a first instance decision. It cannot have been regarded as definitively settling the law in this field. Moreover, if the firm and unanimous decision now being given by the House were given prospective effect only, the result would be that in many existing liquidations preferential creditors would be deprived of the priority Parliament intended they should have. I would reject the bank's submission that this decision of the House should have only prospective effect. I would allow this appeal accordingly.

LORD STEYN

My Lords,

44. I have had the advantage of reading the opinions of my noble and learned friends, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. I am in full agreement with their opinions.

45. In regard to prospective overruling I see the good sense of not saying "never" as explained by my noble and learned friend Lord Nicholls of Birkenhead. On the other hand, like Lord Scott, at present I find it difficult to see how it could be possible to permit prospective overruling in a dispute about the interpretation of a statute.

46. I would also make the order which Lord Scott proposes.

LORD HOPE OF CRAIGHEAD

My Lords,

47. As so often happens when a company goes into creditors' voluntary liquidation, the assets which are available to pay Spectrum's general creditors are insufficient to pay those creditors in full after payment of the preferential debts of the company. Section 175(2)(b) of the Insolvency Act 1986, re-enacting a rule that was first introduced over 100 years ago by the Preferential Payments in Bankruptcy Amendment Act 1897, (60 & 61 Vict, c 19), provides that, so far as the assets of the company available for payment of general creditors are insufficient to meet them, preferential debts have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the company, and that they shall be paid accordingly out of any property comprised in or subject to that charge. It is notorious that this state of affairs operates to the disadvantage of creditors whose claims are secured by a charge which takes the form of a floating charge and not that of a fixed security. From the creditor's point of view, it deprives the floating charge of much of its utility.

48. Section 251 of the 1986 Act provides that the expression "floating charge" means "a charge which, as created, was a floating charge and includes a floating charge within the meaning of section 462 of the Companies Act (Scottish floating charges)." Section 462(1) of the Companies Act 1985, which makes provision for the creation of floating charges in Scotland, states:

> "It is competent under the law of Scotland for an incorporated company…, for the purpose of securing any debt or other obligation (including a cautionary obligation) incurred or to be incurred by, or binding upon, the company or any other person, to create in favour of the creditor in the debt or obligation a charge, in this Part referred to as a floating charge, over all or any part of the property (including uncalled capital) which may from time to time be comprised in its property and undertaking."

That provision must be read together with section 463(1)(b) of the 1985 Act, which declares that where a Scottish company goes into liquidation within the meaning of section 247(2) of the Insolvency Act 1986 a floating charge created by the company attaches to the property then comprised in the company's property and undertaking or, as the case may be, in part of that property and undertaking, but does so subject to the rights of any person who holds a fixed security over the property or any part of it ranking in priority to the floating charge. It must also be read together with section 464(6) the 1985 Act as amended by section 439(1) of and Schedule 13 to the 1986 Act, which states that the order of ranking set out in that section is subject to sections 175 and 176 of the 1986 Act as to the ranking of preferential debts in winding up. So the rule that was first introduced by the 1897 Act for England and Wales applies to Scottish floating charges too.

49. Prior to 1961 it was impossible for a Scottish company to create a floating charge over the whole or any part of its property and undertaking. In *In re Bank of Credit and Commerce International S A (No 8)* [1998] AC 214, 226 Lord Hoffmann, speaking of English law, said that a charge is a security interest created without any transfer of title or possession to the beneficiary. But a charge could not be created without any transfer of title or possession in Scotland. In *Carse v Coppen*, 1951 SC 233, it was conceded that a company registered in Scotland could not create a valid and effectual floating charge over its assets in Scotland, but it was contended that it had done so over its assets in England. This argument was rejected. Lord President Cooper said at p 239 that a floating charge was utterly repugnant to the principles of Scots law, which did not recognise it as creating a security at all. At p 241 he referred to that fact that the reforms in the law which had been effected because of the many criticisms that had been directed against the injustices capable of being inflicted on the trade creditors by the use of floating charges had been expressly confined to companies registered in England. He said that it was unthinkable that this could have been done except upon the view that companies registered in Scotland and subject to Scots law could not create floating charges.

50. This situation was thought to be to the disadvantage of Scottish companies. So the law of Scotland was amended by the Companies (Floating Charges) (Scotland) Act 1961, later extended by the Companies (Floating Charges and Receivers) Act 1972, to enable Scottish companies to give security in this way. The result, in the words of Professor W A Wilson, *"Floating Charges"*, 1961 SLT (News) 53, was that there was now in the law of Scotland a completely new form of security which could be effectively granted over corporeal moveables

without relinquishing possession, over incorporable moveables without giving intimation and over heritage without recording a deed in the Sasine Register. It was, if I may respectfully borrow this phrase from the speech of my noble and learned friend Lord Walker of Gestingthorpe, a cuckoo in the nest of Scots property law – as your Lordships were to discover in the case of *Sharp v Thomson*, 1997 SC (HL) 66, which revealed some of the problems caused by introducing this form of charge into a legal system to which it did not belong naturally.

51. It is, of course, possible under the statutory regime that now applies in Scotland – it is currently to be found in Part XVIII of the 1985 Act – for a company to create a floating charge over its book debts. Indeed, a creditor seeking to secure his debt by means of a floating charge will usually wish to see to it that the property over which the charge extends includes the book debts of the company. But subjecting book debts to a security which will be effective as a fixed charge in Scots law, and will thus escape from the priority which section 175 of the 1986 Act gives to preferential debts, is far less convenient in practice. This is because the law of Scotland still insists that a fixed charge can be created only by delivery of the property which is to be subjected to it into the hands of the creditor or by the equivalent of delivery. The only way in which this can be done in the case of book debts is by obtaining an assignation in security of the right to receive payment of the debt, which is then intimated to the party who is liable to pay the debt to the company. A company which wishes to continue to trade is unlikely to find this method of creating a charge over its book debts acceptable: *Fletcher and Roxburgh*, *The Law and Practice of Receivership in Scotland*, 3rd ed (2005), para 2.10. In practice, therefore, a creditor who wishes to obtain a security from a Scottish company over its book debts will only be able to do this by way of a floating charge.

52. The creation of a charge over book debts which will be effective in English law as a fixed charge does not present the same difficulties. As Slade J said in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, 158, the decision of the House of Lords in *Tailby v Official Receiver* (1888) 13 App Cas 523 showed that it is competent for anyone to whom book debts may accrue in the future to create for good consideration an equitable charge upon those book debts which will attach to them as soon as they come into existence. But if this is to be effective as a fixed security everything depends on the way the security agreement ensures that the charge over the book debts is fixed. It is not easy to reconcile the company's need to continue to collect and

use these sums for its own business purposes with the lender's wish to escape from the priority which section 175(2)(b) gives to preferential debts over the claims of the holder of a floating charge by subjecting the uncollected book debts to a security which will operate as a fixed charge over them.

Did Spectrum's debenture create a fixed charge?

53. My noble and learned friend, Lord Scott of Foscote has described the facts of the case and summarised all the relevant authorities. I adopt with gratitude all that he has said about them, and I agree with him that the charge which the company granted by way of what the debenture described as a specific charge over its book debts and other debts then and from time to time owing to the company was in law a floating charge. It was not a fixed charge, so section 175(2)(b) applies to it. The preferential creditors have priority over the bank's claims under the debenture to the sums realisable from the book debts and other debts of the company.

54. There are, as Professor Sarah Worthington has pointed out, a limited number of ways to ensure that a charge over book debts is fixed: *An 'Unsatisfactory Area of the Law' – Fixed and Floating Charges Yet Again*, (2004) 1 International Corporate Rescue, 175, 182. One is to prevent all dealings with the book debts so that they are preserved for the benefit of the chargee's security. This is the only method which is known to Scots law which, as I have said, insists upon assignation of the book debts to the security holder and its intimation to the company's debtor as the equivalent of their delivery. One can, of course, be confident where this method is used that the book debts will be permanently appropriated to the security which is given to the chargee. But a company that wishes to continue to trade will usually find the commercial consequences of such an arrangement unacceptable. Another is to prevent all dealings with the book debts other than their collection, and to require the proceeds when collected to be paid to the chargee in reduction of the chargor's outstanding debt. But this method too is likely to be unacceptable to a company which wishes to carry on its business as normally as possible by maintaining its cash flow and its working capital. A third is to prevent all dealings with the debts other than their collection, and to require the collected proceeds to be paid into an account with the chargee bank. That account must then be blocked so as to preserve the proceeds for the benefit of the chargee's security. A fourth is to prevent all dealings with the debts other than their collection and to require the collected proceeds to be paid into a

separate account with a third party bank. The chargee then takes a fixed charge over that account so as to preserve the sums paid into it for the benefit of its security.

55. The method that was selected in this case comes closest to the third of these. It was selected, no doubt, because it enabled the company to continue to trade as normally as possible while restricting it, at the same time, to some degree as to what it could do with the book debts. The critical question is whether the restrictions that it imposed went far enough. There is no doubt that their effect was to prevent the company from entering into transactions with any third party in relation to the book debts prior to their collection. The uncollected book debts were to be held exclusively for the benefit of the bank. But everything then depended on the nature of the account with the bank into which the proceeds were to paid under the arrangement described in clause 5 of the debenture. As McCarthy J said in *In re Keenan Bros* Ltd [1986] BCLC 242, 247, one must look, not at the declared intention of the parties alone, but to the effect of the instruments whereby they purported to carry out that intention. Was the account one which allowed the company to continue to use the proceeds of the book debts as a source of its cash flow or was it one which, on the contrary, preserved the proceeds intact for the benefit of the bank's security? Was it, putting the point shortly, a blocked account?

56. I do not see how this question can be answered without examining the contractual relationship in regard to that account between the bank and its customer. An account from which the customer is entitled to withdraw funds whenever it wishes within the agreed limits of any overdraft is not a blocked account. In *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710, 722, para 22 Lord Millett said that the critical feature which led the Irish Supreme Court in *In re Keenan Bros Ltd* [1986] BCLC 242 to characterise the charge on book debts as a fixed charge was that their proceeds were to be segregated in a blocked account where they would be frozen and unusable by the company without the bank's written consent. I respectfully agree. Elsewhere in his judgment he appears to have assumed that the account into which the proceeds of the book debts were to be paid under the debenture in the *Siebe Gorman* case [1979] 2 Lloyd's Rep 142 was also a blocked account: p 727, para 38; p 730, para 48. In para 38 he said that the company could collect the money but was not free to use it as it saw fit. The question whether he was right when he made that assumption is at the heart of this case.

57. For the reasons which have been explained much more fully by Lord Scott and Lord Walker, I too would hold that it is impossible to conclude that the debenture in the *Siebe Gorman* case had that effect. As I read the critical passage in Slade J's judgment at pp158-159, he appears to have reached that conclusion in two stages. First, he said, the effect of the debenture was to create a specific charge on the proceeds of the debts as soon as they were received which prevented the company from disposing of an unencumbered title to them without the mortgagor's consent. Second, he said that the bank would have had the right, if it chose, to assert its lien under the charge on the proceeds of the book debts, even at a time when the account into which they were paid was temporarily in credit.

58. As to the first point, I would agree that the effect of clause 5(c) of the debenture (the equivalent of clause 5 in our case) was that the company was prevented from doing anything with the proceeds of the book debts when collected other than paying them into its account with the bank. But it seems to me that second point – that the bank could assert a lien over the proceeds – overlooks the fact that the account into which the proceeds were to be paid was the company's current account with the bank which the company was to continue to be free to operate for its own business purposes within the agreed limit of its overdraft.

59. As May LJ said in *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340, 1353, the money which a customer deposits with a bank becomes the bank's money, but the bank is prima facie bound to meet its debt when called upon to do so by the customer. In *Westminster Bank Ltd v Hilton* (1926) 43 TLR 124, 126 Lord Atkinson explained the relationship in this way:

> "It is well established that the normal relation between a banker and his customer is that of debtor and creditor, but it is equally well established that *quoad* the drawing and payment of the customer's cheques as against money of the customer's in the banker's hands the relation is that of principal and agent. The cheque is an order of the principal's addressed to the agent to pay out of the principal's money in the agent's hands the amount of the cheque to the payee thereof."

The general rule is that a banker is bound to honour his customer's cheque so long as he has funds in his hands if the account is in credit, or

up to the agreed limit of any overdraft. He may determine the contract at any time on giving notice to the customer. But he cannot refuse to honour cheques drawn before the notice of determination is received.

60. A banker has a general lien over all bills, notes and negotiable instruments belonging to the customer which his customer may have deposited with him in security of the customer's indebtedness to the bank. But a lien is a right to retain possession of property that belongs to someone else, and the banker has no lien over funds which, when deposited in its account by the customer, become his own property. Moreover the relationship is one where, if the account is in credit, the banker is indebted to his customer. So it was a misuse of the word lien to say that the bank could assert a right of that kind over the proceeds: see Buckley LJ in the Court of Appeal in *Halesowen Presswork and Assemblies Ltd v Westminster Bank Ltd* [1971] 1 QB 1, 46, and Viscount Dilhorne and Lord Cross of Chelsea in the same case in the House of Lords [1972] AC 785; Lord Hoffmann in *In re Bank of Credit and Commerce International S A (No 8)* [1998] AC 214, 226. This is not to say that it is impossible to conceive of the creation of an equitable charge over the proceeds of book debts paid into an account in the name the chargor. But the ordinary relationship of banker and customer does not permit the banker, without notice, to refuse to allow his customer to operate a current account as and whenever he wishes while it is credit or is within the limits of any agreed overdraft. The debenture in the *Siebe Gorman* case, which provided for the payment of the proceeds into an account of that kind, lacked any provision which qualified that relationship.

61. In the Court of Appeal Lord Phillips of Worth Matravers MR [2004] Ch 337, 383, para 94 said that, in the determination of the question whether the charge over the book debts was fixed, the extent of the customer's contractual right to draw out sums equivalent to the amounts paid in must be disregarded. But the relationship between a bank and its customer is founded in contract. The company's undertaking in clause 5 of the debenture to pay the proceeds of the book debts into its account with the bank has to be seen and understood in that context. This was a current account into which the company paid money drawn from a variety of other sources as well as the proceeds of its book debts. In my opinion the company's continuing contractual right to draw out sums equivalent to the amounts paid in is wholly destructive of the argument that there was a fixed charge over the uncollected proceeds because the account into which the proceeds were to be paid was blocked.

Should Siebe Gorman be overruled?

62. Lord Phillips of Worth Matravers MR said that, even if Slade J's construction of the debenture in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 had appeared to him to be erroneous, he would have been inclined to hold that the form of the debenture had, by custom and usage, acquired the meaning and effect that he had attributed to it: [2004] Ch 337, 383, para 97. This was because the form had been used for 25 years under the understanding that this was its meaning and effect. Banks had relied upon this understanding, and individuals had guaranteed the liabilities of companies to banks on the understanding that the banks would be entitled to look first to their charges on book debts unaffected by the claims of preferred creditors. The respondents say that this is the course that ought now to be followed in the interests of commercial certainty.

63. The House's Practice Statement of 26 July 1966 reminds us that the use of precedent is an indispensable foundation on which to decide what is the law and how it should be applied in individual cases: *Practice Statement (Judicial Precedent)* [1966] 1 WLR 1234. It promotes the degree of certainty that is needed for the guidance of those who must regulate their affairs according to the law. It is hard to think of an area of the law where the need for certainty is more important than that with which your Lordships are concerned in this case. The commercial life of this country depends to a large extent on the reliability of the security arrangements that are entered into between debtors and their creditors. The law provides the context in which these arrangements are entered into, and it lays down the rules that have to be applied when the arrangements break down. Mistakes as to the law can make all the difference between success and failure when the creditor seeks to realise his security. So a heavy responsibility lies on judges to provide the lending market with guidance that is accurate and reliable. This is so that mistakes can be avoided and transactions entered into with confidence that they will achieve what is expected of them.

64. These are powerful considerations, but I am in no doubt that the proper course is for the *Siebe Gorman* decision to be overruled. It is a tribute to the great respect which Slade LJ's outstandingly careful judgments, both at first instance and the Court of Appeal, have always commanded that his decision in that case has remained unchallenged for so many years. But the fact is that it was a decision that was taken at first instance, and it has now been conclusively demonstrated that the construction which he placed on the debenture was wrong. This is not

one of those cases where there are respectable arguments either way. With regret, the conclusion has to be that it is not possible to defend the decision on any rational basis. It is not enough to say that it has stood for more than 25 years. The fact is that, like any other first instance decision, it was always open to correction if the country's highest appellate court was persuaded that there was something wrong with it. Those who relied upon it must be taken to have been aware of this. It provided guidance, and no criticism can reasonably be levelled at those who felt that it was proper to rely on it. But it was no more immune from review by the ultimate appellate court than any other decision which has been taken at first instance.

Should Siebe Gorman be overruled prospectively?

65. Changes in the law do not occur in a vacuum. Much is likely to depend on whether the change affects situations before the change occurs or whether it affects only situations that come afterwards. On the whole legislation affects the future only and not the past, although awareness of what is to come may well influence the way people conduct their affairs before its commencement. The reverse is true of judicial decisions.

66. In *Hindcastle Ltd v Barbara Attenborough Associates Ltd* [1997] AC 70, 95, my noble and learned friend Lord Nicholls of Birkenhead said that prospective overruling was not yet a principle known in English law. Certainly it is as true today as it was then that it has not yet been adopted as a practice in this country: see para 12 of his speech in this case. But in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, 378-379, Lord Goff of Chieveley declared that it had no place in our legal system. He said:

> "Subject to consideration by appellate tribunals, and (within limits) by judges of equal jurisdiction, what [a judge] states to be the law will, generally speaking, be applicable not only to the case before him but, as part of the common law, to other comparable cases which come before the courts, whenever the events which are the subject of those cases in fact occurred.
>
> It is in this context that we have to reinterpret the declaratory theory of judicial decision…. when the judges state what the law is, their decisions do, in the sense I have described, have a retrospective effect. That is, I believe,

> inevitable. It is inevitable in relation to the particular case before the court, in which the events must have occurred some time, perhaps some years, before the judge's decision is made. But is also inevitable in relation to other cases in which the law as so stated will in future fall to be applied. I must confess that I cannot imagine how a common law system, or indeed any legal system, can operate otherwise if the law is to be applied equally to all and yet be capable of organic change."

Later in the same paragraph he said that a system of prospective overruling, although it had occasionally been adopted elsewhere, had no place in our legal system.

67. In *Ha and another v State of New South Wales* (1997) 189 CLR 465, 503-504 the High Court of Australia was just as firm in its rejection of the invitation that it should, if it came to the conclusion that the tobacco wholesalers' and retailers' licence fees were invalid, overrule the franchise cases prospectively, leaving the authority of those cases unaffected for a period of 12 months:

> "This Court has no power to overrule cases prospectively. A hallmark of the judicial process has long been the making of binding decisions of rights and obligations arising from the operation of the law upon past events or conduct. The adjudication of existing rights and obligations as distinct from the creation of rights and obligations distinguishes the judicial power from non-judicial power. Prospective overruling is thus inconsistent with judicial power on the simple ground that the new regime that would be ushered in when the overruling took effect would alter existing rights and obligations. If an earlier case is erroneous and it is necessary to overrule it, it would be a perversion of judicial power to maintain in force that which is acknowledged not to be the law."

68. I do not think that these declarations can be taken as the last word on this issue, at least so far as the powers of your Lordships' House are concerned. The ability of courts to make prospective rulings, if they have power to do so, can no longer be said to be in question. Section 102 of the Scotland Act 1998 provides that, where a court declares that any provision in an Act of the Scottish Parliament is not within the

competence of the Parliament, it may make an order removing or limiting the effect the decision. Equivalent provisions are to be found in section 110 of the Government of Wales Act 1998 and section 88(1) of the Northern Ireland Act 1998. This power is a limited one, as it is available only where legislation is held to be invalid because it is outside the devolved institution's legislative competence. But it is nevertheless significant. The European Court of Justice has acknowledged that the interpretation it gives to a rule of Community law is limited to clarifying and defining the meaning and scope of that rule as it ought to have been understood and applied from the time of its coming into force: *R (Bidar) v Ealing London Borough Council*, Case C-209/03, [2005] 2 WLR 1078, 1112, para 66. But, as the court said in the same case, it has in exceptional cases limited the temporal effect of its judgments, having regard to the principle of legal certainty, where it is satisfied that those concerned acted in good faith on the basis of the rules considered to be validly in force and that for it not to do so would give rise to serious economic difficulties: paras 67-69; see also the opinion of Advocate General Jacobs in *Banco Populare di Cremona v Agenzia Entrate Ufficio Cremona*, Case C-475/03, para 75. This power has been developed by judicial decision notwithstanding the fact that there is no express treaty base in articles 230-231 EC for its exercise.

69. The fact that the Judicial Committee of the Privy Council has been given this power in devolution cases by statute and that a similar power has been developed by the European Court of Justice does not, of course, answer the question whether the House has the power, in exceptional cases, to do likewise. But it is for the House, as the ultimate court, to define the limits of its own jurisdiction. It can take as its starting point the inherent power which it has under the common law to do whatever is necessary to serve the interests of justice. That power is, of course, subject as our constitution requires to the doctrine of Parliamentary sovereignty. It must respect any limits on its jurisdiction that have may been imposed by Parliament, so long as these are compatible with our treaty obligations under Community law and with the rights that are defined by section 1(1) of the Human Rights Act 1998 as the Convention rights. A statutory limitation which was found to be incompatible would have to be read down under the doctrine of direct effect or under section 3(1) of the 1998 Act to remove the incompatibility. Subject to these exceptions, its jurisdiction is limited only by the fact that the inherent power which is vested in the House in its appellate capacity is a judicial power, not a legislative one.

70. Authority for this approach, if it is needed, is to be found in *R v Bow Street Metropolitan Stipendiary Magistrate (No 2), Ex p Pinochet*

Ugarte [2000] 1 AC 119 in which, in the exercise of its power as the ultimate court of appeal to correct any injustice caused by one of its own orders, the House set aside the decision which it had reached in the first appeal, [2000] 1 AC 61. The respondents did not dispute that the House had jurisdiction in appropriate cases to rescind or vary one of its earlier orders. But Lord Browne-Wilkinson, who delivered the leading speech, went further. At p 132D-E he said that in his judgment that concession was rightly made both in principle and on authority:

> "In principle it must be that your Lordships, as the ultimate court of appeal, have power to correct any injustice caused by an earlier order of this House. There is no relevant statutory limitation on the jurisdiction of the House in this regard and therefore its inherent jurisdiction remains unfettered. In *Broom v Cassell & Co Ltd (No 2)* [1972] AC 1136 your Lordships varied an order for costs already made by the House in circumstances where the parties had not had a fair opportunity to address argument on the point."

The circumstances in that case were, of course, quite different. But the principle which the House was applying there is capable of a much wider application.

71. The question then is whether it can ever be consistent with the exercise of its judicial power for the House to declare that a decision which it takes which changes the law is not to affect events or things done in the past but only events or things done in the future. While I recognise the force of Lord Goff's argument to the contrary in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349, I think that it would be unwise to say that the power to do this can never be available in any circumstances. The speeches that were delivered in *R v Governor of Brockhill Prison, Ex p Evans (No 2)* [2001] 2 AC 19 show how reluctant your Lordships have been to engage in this debate. It is no doubt true that in almost every case that can be imagined the exercise of the judicial power will require the House simply to declare what the law is, with the inevitable result that it will apply to other comparable cases whenever the events occurred. But it is not possible to predict the future with complete confidence, and it seems to me that the question whether this technique should be adopted remains an open one. Richard H S Tur, "Time and Law" (2002) Oxford Journal of Legal Studies, 463, 473, has observed that to apply an admittedly new rule retrospectively is blatantly legislative however fair or otherwise normatively appealing

this may be. At p 474 he said that commentators can agree that prospective overruling has, in Lord Goff's words, "no place in our legal system" but disagree as to whether it should have a place, adding that it might be that in exceptional circumstances, where justice was served thereby, the effect of a judicial decision could expressly be declared to be prospective only. I do not think that we can say that there will never be cases when the interests of justice may require the removal of the retrospective effect of a judgment by making a declaration to that effect.

72. The question whether such a declaration will ever be consistent with the exercise of judicial power must, in the end, depend on the issue that the House is being called upon to decide. In *Arthur J S Hall & Co v Simons* [2002] 1 AC 615, 726H, for example, I said that I was of opinion that the decision in that case which changed the law about the immunity from suit of the advocate should take effect only from the date when the House delivered its judgment. That was a highly unusual case. In the Court of Appeal it was held that the solicitors had not acted as their clients' advocate and their conduct was not so intimately connected with the conduct of the case in court as to attract the immunity. I said at the outset of my speech that the grounds which the Court of Appeal had given for its decision were entirely sound, sufficient and satisfactory and that it was unnecessary for the disposal of the appeal to examine the fundamental question whether the core forensic immunity which the House had recognised in *Rondel v Worsley* [1969] 1 AC 191 could still be justified on grounds of public policy. But the opportunity had been taken of arranging for the case to be heard by seven Law Lords so that it could be considered whether the rule that was established by that case could still be said to be justified. The focus of attention was shifted, quite deliberately, to this issue. The House was no longer interested in the question whether the Court of Appeal had been right to say that the solicitors' conduct was such as not to attract the core immunity. So I did not regard it as necessary for the disposal of the appeal to say that any change as regarded the immunity rule should operate retrospectively. On the contrary, as I said at p 710B:

> "I consider it to be a legitimate exercise of your Lordships' judicial function to declare prospectively whether or not the immunity – which is judge-made rule – is to be available in the future and, if so, in what circumstances."

73. I continue to think that this approach to the exercise of the judicial power in that case was legitimate. There was no need, in order

to do justice between the parties to the disputes, for the decision in *Arthur J S Hall & Son v Simons* [2002] 1 AC 615 to be applied retrospectively. Advocates had arranged their affairs since the decision in *Rondel v Worsley* on the basis that in their conduct of cases in court the core immunity was available. Recognising the importance that is to be attached to legal certainty, there was much to be said for the view that in their case the decision to remove the immunity should operate prospectively only and not retrospectively.

74. Where the future may lead us we cannot tell. So, like my noble and learned friend Lord Nicholls of Birkenhead, I would not rule out the possibility that in a wholly exceptional case the interests of justice may require the House, in the context of a dispute about the state of the common law or even about the meaning or effect of a statute, to declare that its decision is not to operate retrospectively. But I would not consider that approach to be appropriate in this case. The single most important point which indicates the contrary is that, if the decision to overrule *Siebe Gorman* were to be applied prospectively only, it would deprive the preferential claimants of the priority to which, on a correct view of the law, they are entitled under section 175(2)(b) of the 1986 Act. I do not think that it is open to your Lordships in the exercise of the judicial power to deprive a party to the litigation of a legitimate remedy that has undoubtedly been given to him by statute.

Conclusion

75. For the reasons given by Lord Scott and Lord Walker, and for these further reasons of my own, I would hold that the decision in *Siebe Gorman & Co Ltd v Barclays Bank* Ltd [1979] 2 Lloyd's Rep 142 was wrong and should be overruled. I would allow the appeal.

LORD SCOTT OF FOSCOTE

My Lords,

The issues

76. The issue in this case is whether the charge over book debts, present and future, granted by Spectrum Plus Ltd ("Spectrum") to National Westminster Bank Plc ("the bank") under a debenture dated 30 September 1997 was a fixed charge, which it was expressed to be, or merely a floating charge. The bank, naturally, says that it was a fixed charge. Customs & Excise, the Inland Revenue and the Secretary of State for Trade and Industry ("the Crown creditors") say that it was a floating charge. If it was a floating charge Spectrum's preferential creditors are entitled to have their debts paid out of the proceeds of the book debts in priority to the bank (see section 175, Insolvency Act 1986). If it was not a floating charge the preferential creditors have no such priority and the bank will be entitled to the whole of the proceeds. The amount at stake is relatively trivial, no more than £16,136 odd. But this is a test case. Your Lordships have been given to understand that several hundred liquidations are being held up pending the resolution of the issue (see the judgment of the Vice-Chancellor Sir Andrew Morritt [2004] Ch 337, 342). Your Lordships have been told also that the debenture granted by Spectrum was in the bank's normal form and that many other banks and other commercial lenders have taken security over their borrowers' book debts using a similar form of debenture. It is of commercial as well as legal importance that the issue should be resolved.

77. There is a subsidiary issue. The bank has invited your Lordships, if your Lordships conclude that the debenture created merely a floating charge over the book debts, so to rule with prospective effect only. That raises the question whether your Lordships have power to deliver prospective rulings, applicable only in the future, or only to debentures not yet executed. There is also, of course, the question whether, if your Lordships do have such a power, the power should be exercised in the present case. But these are issues for later. The first and main issue is whether the bank's debenture created a fixed charge or only a floating charge over Spectrum's book debts.

The debenture

78. Spectrum carried on the business of a manufacturer of dyes, paints, pigments and other chemical products for the paint industry. In the autumn of 1997 Spectrum changed banks. It opened an account with the bank, obtained an overdraft facility of £250,000 and, on 30 September 1997, executed the debenture to secure its indebtedness to the bank. The security created by the debenture was expressed to include -

> "… [a] specific charge [of] all book debts and other debts … now and from time to time due or owing to [Spectrum]" (para. 2(v))

and

> "[a] floating security [of] its undertaking and all its property assets and rights whatsoever and wheresoever present and/or future including those for the time being charged by way of specific charge pursuant to the foregoing paragraphs if and to the extend that such charges as aforesaid shall fail as specific charges but without prejudice to any such specific charges as shall continue to be effective." (para.2(vii))

79. The expression "specific charge" is potentially ambiguous. It may mean a charge over specific ascertained property or it may mean a fixed charge in contrast to a floating charge, depending on the context. It is clear that in this debenture, as in most others, the expression is intended to bear the latter meaning.

80. There is no doubt that, as Slade J held in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, it is in law possible for a company to create a security consisting of a fixed charge over all its present and future book debts. Nor is there any doubt that the question as to how a particular charge should be categorised depends upon the nature of the rights over the charged asset that have been granted to the chargee or reserved to the chargor. The label that the parties have attributed to the charge may be some indication of the rights the parties were intended to have but is not conclusive.

81. Paragraph 5 of the debenture supported the grant of the charge over books debts -

> "5. With reference to the book debts and other debts hereby specifically charged [Spectrum] shall pay into [Spectrum's] account with the Bank all moneys which it may receive in respect of such debts and shall not without the prior consent in writing of the Bank sell factor discount or otherwise charge or assign the same in favour of any other person or purport to do so and [Spectrum] shall if called upon to do so by the Bank from time to time execute legal assignments of such book debts and other debts to the Bank."

This provision barred Spectrum from dealing with its book debts in any of the ways specified but left Spectrum free to deal with the debtors who owed the debts and, in particular, to collect the debts in the normal course of business.

82. Paragraph 5 required that the debts once collected be paid into Spectrum's account with the bank. This account was a current account. It enjoyed the overdraft facility of £250,000 to which I have referred. Provided that overdraft limit were not exceeded, Spectrum was free to draw on the account for its business purposes. The Bank's Borrowing Terms allowed the bank, by notice, to withdraw or reduce the facility. And amounts outstanding on the account were repayable on demand. These are the normal terms on which overdraft facilities are made available by banks to their customers. This account was in all respects a normal bank current account with an overdraft facility.

83. The question for decision, therefore, is whether a charge over present and future book debts, where the chargor cannot dispose of or charge the uncollected book debts but can deal with its debtors and collect the debts and where the chargor is obliged to place the payments made to it by its debtors in a designated account with the chargee bank but can freely draw on the account for its business purposes provided the overdraft limit is not exceeded, is capable in law of being a fixed charge.

The facts

84. The events that have led to this litigation can be shortly stated. After the opening of the current account in September 1997 Spectrum collected its book debts, paid them into its current account and drew on the account as it wished for its business purposes. The overdraft limit of £250,000 was never exceeded but nor was the account ever in credit. There is no evidence that any instructions regarding Spectrum's drawings from the account or how the account could be used by Spectrum were ever given by the bank or that the bank ever sought to exercise any control over the use made by Spectrum of its withdrawals from the account. But Spectrum's business fortunes did not prosper and on 15 October 2001 it went into voluntary liquidation. At the date of liquidation £165,407 was due to the bank. Spectrum's uncollected book debts at that date had a face value of £291,293, but the liquidators estimated their realisable value to be £156,544. Spectrum's unsecured debts included the £16,136 due to preferential creditors, mainly the Crown creditors. There was a deficiency with regard to creditors in the region of £650,000.

85. The liquidators have so far collected £113,484 in respect of book debts but, pending a resolution of the issue as to the correct categorisation of the charge granted over the book debts, have not accounted for these payments to the bank. Bearing in mind, however, that even if the charge created only a floating charge the bank would be entitled to priority over ordinary creditors and that the amount due to preferential creditors is only £16,136, it seems a little surprising that the liquidators have not accounted to the bank for the balance of the £113,484. But no doubt there is some explanation for this.

The rival lines of judicial authority

86. The issue as to the correct categorisation of the charge created by Spectrum over its book debts has been presented, both in the courts below and before your Lordships, as requiring a choice between rival lines of judicial authority. In *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142 Slade J held that the Barclays Bank debenture had created a fixed charge over the chargor's book debts. There are no material differences between the Barclays Bank debenture in issue in the *Siebe Gorman* case and the bank's debenture in the present case, at least so far as concerns the charge of book debts. The *Siebe Gorman* decision was followed by Knox J in *Ex p Copp* [1989]

BCLC 13 and has been referred to without dissent in other cases at first instance (see eg. *In re Portbase Clothing Ltd* [1993] Ch 388 at 395/6). Moreover in *In re New Bullas Trading Ltd* [1994] 1 BCLC 485 the Court of Appeal took *Siebe Gorman* a step further. The *New Bullas* debenture was expressed to grant a fixed charge over the chargor's present and future book debts but a floating charge over the proceeds of the debts when collected and paid into the chargor's bank account. Collection of the debts was left to the chargor. The chargor went into liquidation and Nourse LJ, with whose judgment the other two members of the court agreed, held that the charge over the book debts owing at the date of liquidation was, as the debenture had stated, a fixed charge. If a charge over book debts can be a fixed charge even though the money received by the chargor in payment of those debts is to be subject to only a floating charge, it becomes difficult to quarrel with the proposition that the charge over uncollected book debts in the present case (or in *Siebe Gorman*) can be a fixed charge even though the chargor can freely use for its business purposes the money it receives from its debtors in payment of the debts subject to the charge.

87. However Hoffmann J's judgment in *In re Brightlife Ltd* [1987] Ch 200 cast some doubt on *Siebe Gorman*. Hoffmann J was presented with a debenture expressed to grant a "first specific charge" of the chargor's book debts, present and future. The debenture did not allow the chargor to dispose of or charge the uncollected book debts but left the chargor free to collect the debts, pay the proceeds into its bank account and draw as it wished on that account. Hoffmann J held that the charge was a floating charge. He distinguished *Siebe Gorman* principally on the ground that the *Siebe Gorman* debenture holder was a bank and the debenture had required the collected debts to be paid into the chargor's account at the chargee bank. In *Brightlife* the debenture holder was not a bank and there was no similar restriction. I must revert to this point of distinction. It suffices for the moment to notice that, despite the description of the charge as a "first specific charge", the *Brightlife* charge was held to be a floating charge because the chargor had been left free to collect the debts, to pay the proceeds into its bank account and to use the account as it wished (see p.209). In the *New Bullas Trading Ltd case* Knox J [1993] BCLC 1389, at first instance, followed *In re Brightlife Ltd*, but was reversed by the Court of Appeal. *In re Brightlife Ltd* was followed also by Millett LJ in *In re Cosslett (Contractors) Ltd* [1998] Ch 495.

88. In *Supercool Refrigeration and Air Conditioning v Hoverd Industries Ltd* [1994] 3 NZLR 300 Tompkins J, sitting in the High Court of New Zealand, declined to follow *Siebe Gorman*. The

debenture in question, as in *Siebe Gorman* and the present case but unlike the debenture in *In re Brightlife Ltd*, was a bank debenture. It was expressed to grant a "fixed charge" over, among other assets, the chargor's book debts present and future. The debenture did not allow the chargor to dispose of or charge its uncollected book debts and required the collected debts to be paid into the chargor's account with the bank. There does not appear to have been any restriction on the ability of the chargor to draw on the account for its trading purposes. Tompkins J noted that "the relevant provisions of the securities in *Siebe Gorman* and the present case are, for practical purposes, the same" (p 318) but held that the charge over the book debts was a floating charge because

> "… a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the Bank. It does not, without more, fasten the charge onto those proceeds".(p 321)

89. And, finally, the same point came before the Privy Council on an appeal from the Court of Appeal of New Zealand in *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710. This case concerned a bank debenture closely modelled on the *New Bullas Trading Ltd* debenture, that is to say, it purported to grant the bank a fixed charge over the chargor's book debts present and future but only a floating charge over the proceeds collected by the chargor (see p 716). The judgment of the Board, delivered by Lord Millett, held that the critical feature which distinguished a floating charge from a fixed charge lay in the chargor's ability, freely and without the chargee's consent, to control and manage the charged assets and withdraw them from the security. *In re Brightlife Ltd*, *In re Cosslett (Contractors) Ltd* and the New Zealand *Supercool Refrigeration* case were approved and applied. *New Bullas Trading Ltd* was held to have been wrongly decided. *Siebe Gorman* was treated, in rather guarded terms, as a case in which Slade J had found sufficient restrictions on the use to which the chargor could put the collected debt payments to warrant the categorisation of the charge as a fixed charge (p 727). But Lord Millett expressed the opinion, at para 36, that

> "A restriction on disposition [of book debts] which nevertheless allows collection and free use of the proceeds is inconsistent with the fixed nature of the charge; it

allows the debt and its proceeds to be withdrawn from the security by the act of the company in collecting it"

The judgments in the courts below

90. The issue has, in the present case, been litigated between the bank on the one side, arguing for a fixed charge, and the Crown creditors on the other side, arguing for a floating charge. Spectrum in liquidation and its liquidators, although parties to the proceedings, have taken no active part.

91. The Vice-Chancellor, having reviewed the cases, said that he was persuaded by Lord Millett's reasoning in *Agnew* that *Siebe Gorman* had been wrongly decided. He held that the charge granted to the bank over Spectrum's book debts was, notwithstanding that it was expressed to be a fixed charge, in law a floating charge. The test, he held, was whether the rights and obligations conferred and imposed by the debenture "disclosed an intention that the company should be free to deal with the book debts and withdraw them from the security without the consent of the Bank" (para 39). The application of this test should, said the Vice-Chancellor, have led to the conclusion in *Siebe Gorman* that the charge was a floating charge: he said "the collection and free use of the proceeds of book debts through the ordinary operation of the bank account was not only permitted but envisaged" (para 39).

92. The Vice-Chancellor referred in his judgment to the criticisms of the Court of Appeal decision in *In re New Bullas Trading Ltd* that had been made by Lord Millett in *Agnew* and to earlier criticisms of that decision made by Professor Roy Goode in an article, "Charges Over Book Debts: A Missed Opportunity" (1994) 10 LQR 592, but did not himself address Nourse LJ's reasoning or conclusions.

93. The Court of Appeal did so, however, when the present case reached them. The Master of the Rolls, Lord Phillips of Worth Matravers, pointed out, correctly in my respectful opinion, that the Vice-Chancellor's test of a floating charge was in conflict with the Court of Appeal decision in *New Bullas Trading* and concluded that the rules of binding precedent enabled neither the Vice-Chancellor nor a subsequent Court of Appeal to rule that that case had been wrongly decided (para 58). This conclusion would, I think, have made it inevitable that the appeal against the Vice-Chancellor's judgment would have been

allowed but the Master of the Rolls went on to consider whether, assuming the *Agnew* test of a floating charge to be applicable, the bank's debenture had had the effect that the company had been left free to use the proceeds of its book debts in the normal course of its business. He concluded that the restrictions imposed by the debenture (and the restrictions imposed by the *Siebe Gorman* debenture) had been sufficient to justify the categorisation of the charge as a fixed charge:

> "It seems to me that it is at least arguable that a debenture which prohibits a chargor from disposing of book debts before they are collected and requires him to pay them, beneficially, to the chargee as and when they are collected properly falls within the definition of a fixed charge, regardless of the extent of his contractual right to draw out sums equivalent to the amount paid in. Strictly speaking the chargor is neither entitled to dispose of the book debts before they fall due for payment, nor to dispose of the proceeds. What he does enjoy are contractual rights to payments, whether as lender or borrower, from the bank" (para 94).

94. On this appeal, therefore, the main issue depends on two questions. First, what is the right test to be applied in order to categorise a charge as a floating charge? Second, if that test is applied in the present case, how should the bank's charge be categorised?

What is a floating charge?

95. It is helpful in answering this question to bear in mind the juridical history of floating charges and the reasons why a degree of statutory intervention became necessary. By the middle of the 19th century industrial and commercial expansion in this country had led to an increasing need by companies for more capital. Subscription for share capital could not meet this need and loan capital had to be raised. But the lenders required security for their loans. Traditional security, in the form of legal or equitable charges on the borrowers' fixed assets, whether land or goods, could not meet the need. The greater part of most entrepreneurial companies' assets would consist of raw materials, work in progress, stock-in-trade and trade debts. These were circulating assets, replaced in the normal course of business and constantly changing. Assets of this character were not amenable to being the subject of traditional forms of security. Equity, however, intervened.

Holroyd v Marshall (1862) 10 HLC 191 was a case in which a debtor had purported to grant a mortgage not only over his existing machinery but also over all the machinery which, during the continuance of the security, should be placed in his mill. The question arose whether the equitable title of the chargee in respect of new machinery that had been placed in the mill prevailed over the rights of a judgment creditor of the chargor/debtor. Could the chargee assert an equitable interest in the new machinery? Lord Campbell LC held that he could not. But the House of Lords reversed the decision, holding that

> "…immediately on the new machinery and effects being fixed or placed in the mill, they became subject to the operation of the contract, and passed in equity to the mortgagees" (per Lord Westbury at p 211)

and that

> "… in equity it is not disputed that the moment the property comes into existence, the agreement operates on it" (per Lord Chelmsford at p 220).

96. *Holroyd v Marshall* opened the way to the grant by companies of security over any class of circulating assets that the chargor company might possess. Acceptance that it was possible to do this became established by the 1870s. In *In re Panama New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318 the company simply charged its "undertaking and all sums of money arising therefrom". Gifford LJ held, at p 322, that "undertaking" meant

> "… all the property of the company, not only which existed at the date of the debenture, but which might afterwards become the property of the company."

He said also that the word "undertaking"

> "… necessarily infers that the company will go on, and that the debenture holder could not interfere until either the interest which was due was unpaid, or until the period

had arrived for the payment of his principal, and that principal was unpaid".

(see also *In re Florence Land and Public Works Co* [1878] 10 Ch D 530, 540).

The two features mentioned by Gifford LJ became the hallmark of the new form of security, namely, (1) a charge on the chargor company's assets, or a specified class of assets, present and future and (2) the right of the chargor company to continue to use the charged assets for the time being owned by it and to dispose of them for its normal business purposes until the occurrence of some particular future event. In *In re Colonial Trusts Corporation* (1879) 15 Ch D 465 Jessel MR referred to this form of security as a "floating security" (see at pp 468, 469 and 472) and in *Moor v Anglo-Italian Bank* (1879) 10 Ch D 681, 687 he contrasted the new form of security with a "specific charge" on the property of the company.

97. By the last decade of the 19th century this form of security, Jessel MR's "floating security", had become firmly established and in regular use. This new form of security, the floating charge, did not derive from statute. It had been bred by equity lawyers and judges out of the needs of the commercial and industrial entrepreneurs of the time. But the new form of security, notwithstanding its convenience for both borrowers and lenders, had its drawbacks for others. Those dealing with a company could not tell whether its circulating assets were subject to a charge that, if the company became insolvent or ceased business, would allow a debenture holder to "step in and sweep off everything" (Lord Macnaghten in *Salomon v Salomon & Co. Ltd* (1897) 10 AC 22, 53). And if a debenture holder did "step in and sweep off everything" there would be nothing left for unsecured creditors including, in particular, the company's employees to whom wages arrears might be owing.

98. Statutory intervention began in 1897 with the Preferential Payments in Bankruptcy Amendment Act. Where a company was being wound-up or was in receivership sections 2 and 3 of the 1897 Act gave preferential creditors, a class which included employees as well as Crown creditors, priority over the chargee under a floating charge, so far as payment of debts out of the assets subject to that charge was concerned. Preferential creditors had priority anyway over ordinary creditors and the sections did not disturb the priority over ordinary creditors to which the charge holder was entitled by virtue of the charge.

These statutory provisions, with very little alteration, are now to be found in sections 40 (receivership) and 175 (winding-up) of the Insolvency Act 1986. And in 1900 further statutory interventions required floating charges to be registered: (see now sections 395 and 396, Companies Act 1985) and provided for floating charges created by an insolvent company within a short period before the commencement of its winding-up to be invalid except to the extent of new money provided by the chargee (see now section 245 Insolvency Act 1986). The statutes which first introduced these reforms did not attempt any definition of a "floating charge". Nor have any of their statutory successors done so. The expression has been taken to be self-explanatory. It bears the meaning attributed to it by judicial decision. But the judicial process over the years whereby the concept of a "floating charge" has been developed must, in my opinion, keep in mind the mischief that these statutory reforms were intended to meet and, in particular, that on a winding-up or receivership preferential creditors were to have their debts paid out of the circulating assets, sometimes referred to as "ambulatory" assets, of the debtor company in priority to a debenture holder with a charge over those assets.

99. The classic and frequently cited definition of a floating charge is that which was given by Romer LJ in the Court of Appeal in the *Yorkshire Woolcombers Association* case [1903] 2Ch 284, 295.

> "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 further 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."

But it is important to notice that Romer LJ prefaced his definition with a qualification. He said -

> "I certainly do not intend to attempt to give an exact definition of the term 'floating charge', nor am I prepared

> to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics …".

The case came to this House under the name *Illingworth v Houldsworth* [1904] AC 355. In short *ex tempore* speeches their Lordships upheld the Court of Appeal. Lord Macnaghten described the case as "clear" and offered the following definition of a floating charge in contrast to a "specific charge" -

> "A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp"(p 358).

100. And a few years later Buckley LJ in *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979, 999 similarly contrasted a "floating security" with a "specific security".

> "[A floating security] is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a licence to the mortgagor to dispose of them in the course of his business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security".

101. It is in the nature of commercial lenders to want the most effective security that they can get. It is in the nature of commercial borrowers to want to be able to carry on the business for the purposes of which they are borrowing money with as much freedom from restrictions imposed by their lenders that negotiation can achieve for

them. But the lenders are usually in the stronger bargaining position and able to stipulate the terms to be included in the debenture which will constitute their security. So it is not in the least surprising to find attempts by lenders to obtain fixed charges as security rather than floating charges, thereby avoiding the need, if financial misfortune were to visit their borrowers, to yield priority to preferential creditors and also avoiding possible vulnerability under section 245 of the 1986 Act or its statutory predecessors. And it is not surprising to find borrowers agreeable to co-operate in these attempts provided their ability to carry on business in the normal way were not unduly impeded.

102. There was never any doubt that it was possible to create a fixed charge over a specific, ascertained book debt. And *Tailby v The Official Receiver* (1888) 13 App Cas 523 established that an assignment of future book debts would be effective to vest in the assignee an equitable interest in the future debts at the moment they became owing to the assignor. So there was no reason why a debenture should not be expressed to assign to the debenture holder, by way of security, the company's future book debts. But the question would still remain whether such an assignment, not being an out-and-out assignment as in *Tailby v The Official Receiver* but an assignment by way of security, could be said to constitute a fixed security.

103. There was nothing much that the lenders could do about the third of the characteristics that Romer LJ had regarded as typical of floating charges. Most commercial borrowers would be unlikely to agree to grant charges over their circulating assets that did not enable them to use those assets for their normal business purposes. So it was natural for the quest for fixed charges to be concentrated on the prominence given by Lord Macnaghten in the *Yorkshire Woolcombers* case to the characteristic of a fixed charge as being a charge on "ascertained and definite property" As soon as a book debt is incurred and becomes owing to the chargor it constitutes an item of "ascertained and definite" property and would qualify as a possible object of a fixed charge. So a debenture expressed to grant a fixed charge over present and future book debts would be capable of creating a fixed charge over all such debts as and when they accrued due to the chargor company. Slade J so held in *Siebe Gorman* and no-one has suggested that in that respect he was wrong.

104. Moreover, the debenture could fortify the apparently fixed character of the charge by including a provision entitling the chargee to call for a formal written assignment by the chargor of the debts as they

accrued. Such an assignment unaccompanied by written notice to the debtor would constitute the chargee equitable proprietor, and not simply equitable chargee, of the debt. The appearance of a fixed security would be fortified. It is not surprising, therefore, to find debentures containing provisions of this sort. The *Siebe Gorman* debenture did so. So did the bank's debenture in the present case. But the intention of the parties that the charge over book debts created and fortified in this way would be a fixed charge has to take account also of Romer LJ's third characteristic of a floating charge, namely, that until some further step by way of intervention is taken by the chargee the chargor company can use the assets in question for its normal business purposes and, in using them, remove them from the security. The fact that a valid fixed charge over present and future book debts is capable of being created does not answer the essential question whether a fixed charge over assets that remain at the disposal of the chargor can be created.

105. Slade J in *Siebe Gorman* [1979] 2 Lloyd's Rep 142, 158 inclined to the opinion that if the chargor of book debts, having collected the book debts,

> "… [had] had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit … the charge on such book debts could be no more than a floating charge."

Hoffmann J in *In re Brightlife Ltd* [1987] Ch 200, 209, in a passage cited with approval by Lord Millett in *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710, 723, said that the significant feature of the *Brightlife* debenture was that the company was free to collect its debts and pay the proceeds into its bank account. He went on

> "Once in the account, they would be outside the charge over debts and at the free disposal of the company. In my judgment a right to deal in this way with the charged assets for its own account is a badge of a floating charge and is inconsistent with a fixed charge."

Similar conclusions were expressed in *In re Keenan Bros Ltd* [1986] BCLC 242 in the Supreme Court of Ireland and by Tompkins J in the *Supercool Refrigeration* case [1994] 3 NZLR 300, in New Zealand.

106. The Privy Council in the *Agnew* case agreed with these decisions. Lord Millett pointed out, in para 13 of the Board's opinion, that Romer LJ's first two characteristics, although typical of a floating charge, were not distinctive of it. They were not necessarily inconsistent with a fixed charge. It was the third characteristic, Lord Millett said, which was the hallmark of a floating charge and distinguished it from a fixed charge.

107. I respectfully agree. Indeed if a security has Romer LJ's third characteristic I am inclined to think that it qualifies as a floating charge, and cannot be a fixed charge, whatever may be its other characteristics. Suppose, for example, a case where an express assignment of a specific debt by way of security were accompanied by a provision that reserved to the assignor the right, terminable by written notice from the assignee, to collect the debt and to use the proceeds for its (the assignor's) business purposes, ie, a right, terminable on notice, for the assignor to withdraw the proceeds of the debt from the security. This security would, in my opinion, be a floating security notwithstanding the express assignment. The assigned debt would be specific and ascertained but its status as a security would not. Unless and until the right of the assignor to collect and deal with the proceeds were terminated, the security would retain its floating characteristic. Or suppose a case in which the charge were expressed to come into existence on the future occurrence of some event and then to be a fixed charge over whatever assets of a specified description the chargor might own at that time. The contractual rights thereby granted would, in my opinion, be properly categorised as a floating security. There can, in my opinion, be no difference in categorisation between the grant of a fixed charge expressed to come into existence on a future event in relation to a specified class of assets owned by the chargor at that time and the grant of a floating charge over the specified class of assets with cystallisation taking place on the occurrence of that event. I endeavoured to make this point in *In re Cosslett (Contractors) Ltd* [2002] 1 AC 336, 357, para 63. Nor, in principle, can there be any difference in categorisation between those grants and the grant of a charge over the specified assets expressed to be a fixed charge but where the chargor is permitted until the occurrence of the specified event to remove the charged assets from the security. In all these cases, and in any other case in which the chargor remains free to remove the charged assets from the security, the charge should, in principle, be categorised as a floating charge. The assets would have the circulating, ambulatory character distinctive of a floating charge.

108. The debenture in the *New Bullas Trading* case [1994] 1 BCLC 485 had features which illustrate the ingenuity of equity draftsmen in

seeking to produce for their clients fixed charges out of circumstances that would normally be associated with floating charges. The debenture was expressed to grant the chargee a fixed charge over the company's present and future book debts. The chargee was entitled to demand that the debts be assigned to it, but never in fact made any such demand. The chargee was entitled to give the chargor instructions as to how the chargor should deal with its book debts, but apparently never in fact gave any such instructions, at any rate none prior to liquidation. The debenture left the chargor free to collect the debts and required the chargor to pay into a specified bank account all money it received in payment of the debts. The debenture then provided that on payment of the money into the bank account the fixed charge would be released and replaced by a floating charge over the money in the account. The obvious intention of these provisions was that on the occurrence of a crystallisation event, eg liquidation, the uncollected book debts at that time would be subject to the fixed charge notwithstanding that if the debts had been paid prior to the crystallisation event the collected money would have been subject to only a floating charge. The preferential creditors would then enjoy no priority over the debenture holder so far as the uncollected debts were concerned.

109. Nourse LJ could see no reason in law to prevent the parties from providing for a fixed charge on book debts while uncollected but a floating charge on the money collected. He referred at p 492 to the question and answer posed by Lord Macnaghten in *Tailby v Official Receiver* 13 App Cas 523, 545 -

> "Between men of full age and competent understanding ought there to be any limit to the freedom of contract but that imposed by positive law or dictated by considerations of morality or public policy? The limit proposed is purely arbitrary, and I think meaningless and unreasonable."

These reservations, he thought, supported the view that it was open to contracting parties, if they wished to do so, to provide for a fixed charge on uncollected book debts but a floating charge on the money received in payment of those debts.

110. Lord Millett expressed the Board's disagreement with Nourse LJ's reasoning and conclusion. Essentially Lord Millett challenged the notion that the security rights granted over a book debt could be any greater than the rights, if any, granted over the money received in

payment of the debts (see [2001] 2 AC 710, para 46). If a book debt were to be charged as security but with an accompanying provision that any money received from the debtor in payment of the debt would belong to the chargor, the so-called 'charge', whether expressed to be a fixed charge or a floating charge, would not be a security at all. It would not constitute a possible source for the repayment of the allegedly secured debt. As Lord Millett said, it would be worthless. If the accompanying provision were, instead, to say that any money received from the debtor would be subject to a floating charge, that provision would, in my opinion, necessarily describe and limit the nature of the charge over the receivable debt. And if the charge were to be expressed to be a fixed charge as respects the receivable debt but a floating charge as respects the money received from the debtor there would be an internal contradiction in the formulation of the charge. Since the essential value of a book debt as a security lies in the money that can be obtained from the debtor in payment it seems to me that Lord Millett was right in concluding that such a security should be categorised as a floating security and that *New Bullas* [1994] 1 BCLC 485 was wrongly decided.

111. In my opinion, the essential characteristic of a floating charge, the characteristic that distinguishes it from a fixed 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 to remove it from the security. On this point I am in respectful agreement with Lord Millett. Moreover, recognition that this is the essential characteristic of a floating charge reflects the mischief that the statutory intervention to which I have referred was intended to meet and should ensure that preferential creditors continue to enjoy the priority that section 175 of the 1986 Act and its statutory predecessors intended them to have.

Did the bank's debenture create a fixed charge or only a floating charge?

112. If, as I think, the hallmark of a floating charge and a characteristic inconsistent with a fixed charge is that the chargor is left free to use the assets subject to the charge and by doing so to withdraw them from the security, how should the charge over book debts granted by the bank's debenture be categorised? The following features of the debenture and the arrangements regarding the bank account into which the collected debts had to be paid need to be taken into account.

(1) The extent of the restrictions imposed by the debenture (para 81 above)
(2) The rights retained by Spectrum to deal with its debtors and collect the money owed by them (para 81 above)
(3) Spectrum's right to draw on its account with the bank into which the collected debts had to be paid, provided it kept within the overdraft limit (para 82 above)
(4) The description "fixed charge" attributed to the charge by the parties themselves.

113. Restrictions on Spectrum's right to deal with its uncollected book debts go very little way, in my opinion, in supporting the characterisation of the charge as a fixed charge for the reasons I have given in criticising the *New Bullas* decision. It is restrictions on the use that Spectrum could make of the payments made by its debtors that are important. I have already cited the passage at p.158 from Slade J's judgment in *Siebe Gorman*[1979] 2 Lloyd's Rep 142, 158 (para 105 above) and need not repeat it. It makes the same point.

114. Moreover, the restrictions on Spectrum's right to deal with its uncollected book debts did not enable the bank to realise its security over those uncollected book debts. The bank could not have sold the book debts without first taking some step or steps that would have given it the power to do so. In effect a crystallisation event would, I think, have had to take place. The value of the uncollected book debts as a security lay always in the money that could be obtained from the debtors in payment of those debts.

115. The bank's debenture required all payments of book debts received by Spectrum to be paid into its account with the bank. The money once received by the bank would become the bank's money and in return Spectrum's account would be credited with the amount that had been received. Whether the account was for the time being in credit or in debit the result of each payment would be the accrual to Spectrum of the right to withdraw from the account a corresponding amount for its normal business purposes.

116. An attempt has been made to justify the categorisation of the charge as a fixed charge by looking no further than the receipt by the bank, through the operation of the clearing system, of the proceeds of the cheques from Spectrum's debtors that were paid in by Spectrum.

The consequent crediting of Spectrum's account with amounts equal to the proceeds of the cheques and Spectrum's ability to draw on that account for its business purposes is not inconsistent, it is suggested, with the categorisation of the charge over the book debts as a fixed charge. This is the point being made by the Master of the Rolls in para 94 of his judgment (cited in para 93 above). It was a point pressed before your Lordships by Mr Moss QC, counsel for the bank. Your Lordships should not, in my opinion, accept this argument. It seeks to perpetuate what I regard as the *New Bullas* heresy, namely, that the categorisation of a charge over book debts can ignore the rights of the chargor over the money received in payment of those debts. The expression "floating charge" has never been a term of art but is an expression invented by equity lawyers and judges to describe the nature of a particular type of security arrangement between lenders and borrowers. The categorisation depends upon the commercial nature and substance of the arrangement, not upon a formalistic analysis of how the bank clearing system works. If part of the arrangement is that the chargor is free to collect the book debts but must pay the collected money into a specified bank account, the categorisation must depend, in my opinion, on what, if any, restrictions there are on the use the chargor can make of the credit to the account that reflects each payment in.

117. The bank's debenture placed no restrictions on the use that Spectrum could make of the balance on the account available to be drawn by Spectrum. Slade J in *Siebe Gorman* [1979] Lloyd's Rep 142, 158 thought it might make a difference whether the account were in credit or in debit. I must respectfully disagree. The critical question, in my opinion, is whether the chargor can draw on the account. If the chargor's bank account were in debit and the chargor had no right to draw on it, the account would have become, and would remain until the drawing rights were restored, a blocked account. The situation would be as it was in *In re Keenan Bros* Ltd [1986] BCLC 242. But so long as the chargor can draw on the account, and whether the account is in credit or debit, the money paid in is not being appropriated to the repayment of the debt owing to the debenture holder but is being made available for drawings on the account by the chargor.

118. Slade J said that the debenture in the *Siebe Gorman* case

> "… creat[ed] in equity a specific charge on the proceeds of [the book debts] as soon as they are received and consequently prevents the mortgagor from disposing of an unencumbered title to the subject matter of such charge

> without the mortgagee's consent, even before the mortgagee has taken steps to enforce its security". (p 159)

But it is very difficult to see what feature of the arrangement between chargor and bank chargee in *Siebe Gorman* justified this conclusion. The debenture was on all fours with the debenture in the present case. There is nothing in the report of the case to suggest that the bank account into which the chargor had to pay the collected book debts was other than, as here, a normal bank current account on which the chargor could draw for its normal business purposes. In considering the cited passage it seems to me worth noting that the issues that Slade J had to decide in the *Siebe Gorman* case did not include the question whether the charge over book debts was a fixed charge or a floating charge. The main issue in the case was one of priority as between the bank chargee on the one hand and a subsequent assignee of the charged book debts on the other. This issue turned on notice. Did the subsequent assignee have notice of the bank's charge and the provision barring subsequent assignments? If the subsequent assignee did have notice, the bank would have priority. If not, the subsequent assignee would have priority. The categorisation of the charge did not matter.

119. Slade J in *Siebe Gorman*, Nourse LJ in the *New Bullas* case, and Mr Moss QC in his submission on behalf of the bank in the present case, attributed considerable significance to the labels that the parties to the debenture had chosen to attribute to the charge over book debts. Mr Moss indeed argued that a debenture expressed to grant a fixed charge thereby limited by necessary implication the ability of the chargor to deal with the charged assets. He argued that Spectrum had no right without the consent of the bank to draw on the account into which the cheques received by Spectrum in payment of its book debts had to be paid. This limitation was, he said, an inevitable result of the grant by the debenture of the fixed charge. This argument, my Lords, puts the cart before the horse. The nature of the charge depends on the rights of the chargor and chargee respectively over the assets subject to the charge. The moneys in the bank account were assets subject to the charge. If the account had been treated as a blocked account, so long as it remained overdrawn, it would be easy to infer from a combination of that treatment and the description of the charge as a fixed charge that Spectrum had no right to draw on the account until the debit on the account had been discharged. But the account was never so treated. The overdraft facility was there to be drawn on by Spectrum at will. In the operation of the account there was never a suggestion that Spectrum needed to obtain the bank's consent before writing a cheque. The bank could, by notice, have terminated the overdraft facility, required

immediate repayment of the indebtedness and turned the account into a blocked account. Pending such a notice, however, Spectrum was free to draw on the account. Its right to do so was inconsistent with the charge being a fixed charge and the label placed on the charge by the debenture cannot, in my opinion, be prayed–in-aid to detract from that right.

120. The correct conclusion, in my opinion, is that the debenture, although expressed to grant the bank a fixed charge over Spectrum's book debts, in law granted only a floating charge. I think the Vice-Chancellor, save for the precedent point, was correct in his reasoning and his conclusion.

Prospective overruling

121. Mr Moss has submitted on behalf of the bank that if your Lordships should conclude that the *Siebe Gorman* debenture ought to have been held to have created a floating charge over the book debts your Lordships should so rule with prospective effect only. I take this submission to mean that the overruling of *Siebe Gorman* would not affect any debenture granted before the date on which your Lordship's opinions were made public. This submission raises two questions. The first is whether your Lordships, having come to a conclusion on some issue of disputed law and ruled accordingly, have any power to postpone the coming into effect of that ruling. The second question, if your Lordships do have that power, is whether this is a case in which it should be exercised.

122. My Lords, I find the second question a very easy one. I can see no good reason for postponing the effect of the overruling of *Siebe Gorman.* If *Siebe Gorman* had been a decision of this House and therefore, subject to subsequent legislative intervention or to an overruling of the decision pursuant to the 1966 Practice Statement (Judicial Precedent) [1966] 1 WLR 1234, a decision that settled the law with finality, I think your Lordships would have need to hesitate long before overruling. But the rulings of lower courts on points of law do not settle the law with finality. They never have done. It was natural that banks and other lenders taking security from corporate borrowers should have modelled their security on the debenture form that had achieved success in *Siebe Gorman*. But they would not, or at least should not, have done so on the footing that Slade J's judgment had finally settled the law. Mr Moss has submitted that the bank's lending decisions, whether to lend, how much to lend, how much interest to

charge, and so on, were taken in the belief that the *Siebe Gorman* decision on fixed charges over book debts would stand, and that otherwise different decisions might have been taken. My Lords, I am highly sceptical. Banks are in business to receive and hold money for their customers and to lend on that money to others who want to borrow. This is a highly competitive business. The proposition, that the terms on which the bank would have allowed Spectrum a £250,000 overdraft facility would have been significantly different if it had known that its charge over Spectrum's present and future books would be no more than a floating charge, is one that, for me, carries no ring of conviction whatever.

123. The question whether the House has power to postpone the coming into effect of a ruling on a point of law does not, therefore, strictly arise. But your Lordships have had the advantage of detailed submissions on the point, not only from counsel for the bank and for Spectrum but also from Mr Ian Glick QC, who was appointed by the Attorney General, at their Lordships' request, to act as *amicus curiae* to assist your Lordships on this point. In these circumstances I think I should express my view on the point.

124. The question whether judges in giving judgments make law or simply declare existing law is one that has been debated by generations of law students in universities and law schools across the globe. It will continue to be so. There is no single and absolute answer. There is no doubt that it is one of the functions of judges in a common law country to try and develop the common law so that it serves the needs of the time. To that extent at least it is not controversial to say that judges make new law and it may be that in this area it would be open to the House to give a prospective ruling as to what the law would require of individuals in particular situations. Your Lordships' opinions in *Royal Bank of Scotland v Etridge (No 2)* [2002] 2 AC 773 may be regarded as an example.

125. But where the issue is as to the meaning of and effect that should be given to a statutory provision on which the rights of the litigating individuals turn, different considerations come into play. It may be a function of judges incrementally to develop the common law, but it is a duty of judges faithfully to interpret and apply the statutory law. This duty applies as much to the "always speaking" statute as to other statutes. The notion that a judge could decide what a statute meant and required and then announce that the effect of the ruling would be postponed for some period or other seems to me inconsistent with that

duty. It is for Parliament, not judges, to decide when statutes are to come into effect. It is for judges to interpret and apply the statutes. Where interpretation and application of a statute is the issue, a prospective ruling would absent legislative authority (eg the provisions in the 1998 devolution legislation: see para 17 of the opinion of my noble and learned friend Lord Nicholls of Birkenhead), appear to constitute an improper usurpation by the judiciary of the role of the legislature.

126. Lord Nicholls has reviewed in depth the jurisprudential pros and cons of a prospective overruling and has concluded that, even where interpretation and application of a statute is the issue, the door should be kept open for the possibility of such a ruling in an exceptional case (see para 39 of his opinion). I would respectfully agree with his comment about the wisdom of a "never say never" approach but find myself unable to visualise circumstances in which it would be proper for a court, having reached a conclusion as to the correct meaning of a statute, to decline to apply to the case in hand the statute thus construed. Section 1 of the Bill of Rights 1688 declared that

> "… the pretended power of suspending of laws or the execution of laws by regall authority without consent of Parliament is illegall."

It is probably right that the exercise of judicial authority is not caught by the reference to "regall authority" in the Bill of Rights but your Lordships in this House exercise an appellate jurisdiction deriving from the Queen in Council and if the promoters of the Bill of Rights in 1688 had been asked whether there was a power in the House of Lords to suspend laws without the consent of Parliament I do not think it is difficult to guess what their answer would have been.

127. The present case requires a decision as to whether the bank's charge over Spectrum's book debts was a fixed charge or a floating charge. The decision is necessary because statute has given statutory priority to preferential creditors over debenture holders so far as payment of debts out of assets subject to a floating charge is concerned. If your Lordships decide the charge was a floating charge, it is not, in my opinion, open to your Lordships to deprive the preferential creditors of the rights given to them by statute. To do so would be to suspend a law that Parliament has enacted and would, in my opinion, be contrary to the spirit and, perhaps, the letter of the Bill of Rights.

Conclusion

128. For all these reasons, and for the reasons given by my noble and learned friend, Lord Walker of Gestingthorpe, with which I agree, I would allow this appeal and restore paragraphs 1 and 2 of the order of the Vice-Chancellor. The bank must pay the costs here and below.

LORD WALKER OF GESTINGTHORPE

My Lords,

129. I agree that this appeal should be allowed, and that the normal effect of allowing the appeal should not be limited in any way. I gratefully adopt the summary of the facts in the opinion of my noble and learned friend, Lord Scott of Foscote. I agree with his opinion on the substantive issue, and also with that of my noble and learned friend, Lord Hope of Craighead. But because of the general interest and importance of this appeal I wish to state my opinion in my own words.

The history of the floating charge

130. The origins and early history of the floating charge have been clearly explained in a lengthy passage in the opinion of the Privy Council, delivered by Lord Millett, in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 717-721, paras 5-15. This passage shows how the development of the floating charge was enthusiastically encouraged by some of the great Chancery judges of the late 19th century, who were robust defenders of freedom of contract. But after the floating charge had, with great rapidity, grown to maturity, there was something of a reappraisal. The floating charge had become a cuckoo in the nest of corporate insolvency.

131. Two quotations from speeches of Lord Macnaghten, eight years apart, serve to illustrate this. In *Tailby v Official Receiver* (1888) 13 App Cas 523, 545, he said,

> "It was admitted by the learned counsel for the respondent, that a trader may assign his future book debts in a specified business. Why should the line be drawn there? Between men of full age and competent understanding ought there to be any limit to the freedom of contract but that imposed by positive law or dictated by considerations of morality or public policy?"

But in *Salomon v Salomon & Co Ltd* [1897] AC 22, 53, he said,

> "For such a catastrophe as has occurred in this case some would blame the law that allows the creation of a floating charge. But a floating charge is too convenient a form of security to be lightly abolished. I have long thought, and I believe some of your Lordships also think, that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is."

132. *Salomon v Salomon & Co Ltd* was decided by this House on 16 November 1896. With remarkable promptness Parliament responded by enacting sections 2 and 3 of the Preferential Payments in Bankruptcy Amendment Act 1897 ("the 1897 Act"), applicable in winding-up and receivership respectively. These provisions did not give preference to the trade creditors whom Lord Macnaghten had in mind, but the mischief aimed at was the "scandal" to which Lord Macnaghten had referred. The widespread use of floating charges over trading stock, book debts and other circulating capital produced a situation in which a company's business might appear to be thriving and prosperous, with goods on its shelves and customers at its doors, until a sudden and unexpected crystallisation of a floating charge revealed that nothing at all was left for the company's unsecured creditors, even if they were preferential creditors.

133. The perceived mischief was therefore akin to that underlying the doctrine of reputed ownership in bankruptcy, that creditors should not be misled by appearances. The requirement for registration of floating charges, first introduced in 1900, had the same aim, and was comparable

to the requirement for registration of bills of sale. In the United States of America the courts took the same line of thought a good deal further, and rejected floating charges as fraudulent in character: *Wallace Benedict, Receiver v Ratner* (1925) 268 US 353.

134. Sections 2 and 3 of the 1897 Act provided for the claims of preferential creditors to rank ahead of those secured by a floating charge. In doing so it referred to a "floating charge" without providing any statutory definition of that expression. Parliament evidently regarded the concept of a floating charge as sufficiently certain in meaning as not to require definition. Parliament took the same course when registration of floating charges was introduced in 1900, and in all later relevant statutes. The lack of a statutory definition, and the difficulties of providing a clear and comprehensive definition, were discussed by the Court of Appeal in *In re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 (especially a much-cited passage in the judgment of Romer LJ at p295) and by this House on appeal in the same case under the name of *Illingworth v Houldsworth* [1904] AC 55.

Upgrading the security to a fixed charge

135. These difficulties have not diminished over the years. Sections 2 and 3 of the 1897 Act (now re-enacted, with a refinement as to timing, as sections 175 (2) (b) and 40 (2) respectively of the Insolvency Act 1986) make a floating charge more precarious as a security. Banks and other large commercial lenders have therefore tried, for understandable reasons, to upgrade their security by imposing fixed (and not merely floating) charges on parts of a trading customer's circulating capital, especially book debts. This chapter of commercial history has been described by Professor Sir Roy Goode QC, *Legal Problems of Credit and Security*, 3rd ed. (2003) pp121-123. In practice, most standard forms of debenture make the charge extend not just to book debts but to all present and future "book debts and other debts", the extent of which expression was considered by Hoffmann J in *In re Brightlife Ltd* [1987] Ch 200, 204-5; but nothing turns on that in this appeal. In considering the practical effect of charges on debts it should be borne in mind that money paid into a trading company's bank account will not necessarily represent the proceeds of debts of any description, especially if the trader is a retailer making a large number of cash sales, either over the counter or on a "cash with order" basis.

136. Banks and their advisers have had some success in their efforts to upgrade their security. It is quite clear that a fixed charge on book debts, present and future, is conceptually possible. That was the most important point decided (or at any rate confirmed) by Slade J in *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142, and the Crown, the appellant in this appeal, does not seek to cast any doubt on that general proposition. The Crown challenges the decision on a much narrower point, that is the correct construction of the particular form of debenture which was before the Court. But that narrow point is itself of considerable general importance because the *Siebe Gorman* form has become a precedent and has been widely used, either in precisely the same words or in very similar words, by numerous banks.

137. In *Siebe Gorman*, Slade J decided that the form of debenture before him did on its true construction restrict the borrower, R H McDonald Ltd ("McDonald") in making use of the proceeds of collected debts in the ordinary course of its business. Slade J clearly accepted that, in the absence of such a restriction, the charge on debts could not as a matter of law have been more than a floating charge, even though the parties described it as a fixed (or specific) charge. He said at p 158,

> "if I had accepted the premise that [McDonald] would have had the unrestricted right to deal with the proceeds of any of the relevant book debts paid into its account, so long as that account remained in credit, I would have been inclined to accept the conclusion that the charge on such book debts could be no more than a floating charge."

The Crown has little quarrel with that, except perhaps for the adjective "unrestricted."

The essential difference

138. This passage brings us close to the issue of legal principle, that is the essential difference between a fixed charge and a floating charge. 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. The chargee may have good commercial reasons for agreeing to a partial release. If for

instance a bank has a fixed charge over a large area of land which is being developed in phases as a housing estate (another example of a fixed charge on what might be regarded as trading stock) it might be short-sighted of the bank not to agree to take only a fraction of the proceeds of sale of houses in the first phase, so enabling the remainder of the development to be funded. But under a fixed charge that will be a matter for the chargee to decide for itself.

139. Under a floating charge, by contrast, the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a *fund* of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the trader, and not the bank, to decide how to run its business. There is a detailed and helpful analysis of the matter, with full citation of authority, in Professor Sarah *Worthington's Proprietary Interests in Commercial Transactions* (1996) pp 74-77; see also her incisive comment on this case ("An Unsatisfactory Area of the Law—Fixed and Floating Charges Yet Again") in (2004) 1 International Corporate Rescue 175. So long as the company trades in the ordinary way (a requirement emphasised by Romer L J in the *Yorkshire Woolcombers* case [1903] Ch 284, 295, and by the Earl of Halsbury on appeal in the same case, [1904] AC 355, 357-8) the constituents of the charged fund are in a state of flux (or circulation). Trading stock is sold and becomes represented by book debts; these are collected and paid into the bank; the trader's overdraft facility enables it to draw cheques in favour of its suppliers to pay for new stock; and so the trading cycle continues.

140. I have drawn attention to Slade J's reference to an "unrestricted" right to deal with the proceeds of collected debts. It is clear that not every restriction on a trader's freedom of action is a badge of a fixed charge: see *Brightlife* [1987] Ch 200, 209. A prohibition on factoring or otherwise dealing with uncollected debts does not prevent the trader from collecting the debts itself. But if the terms of the debenture were such as to require the trader to pay all its collected debts into the bank and to prohibit the trader from drawing on the account (so that the account is blocked), a charge on debts, described as a fixed or specific charge, would indeed take effect as such (see *Re Keenan Brothers Ltd* [1986] BCLC 242, a decision of the Supreme Court of Ireland, followed by Morritt J in *William Gaskell Group Ltd v Highley* [1994] 1 BCLC 197). In those circumstances the chargee would be in control, prior to crystallisation, and the trader would be unable to trade in the ordinary way without the chargee's positive concurrence. In *Agnew*, Lord Millett pointed out ([2001] 2 AC 710, 730, para 48) that it was not enough to

provide in the debenture for an account to be blocked, if it was not in fact operated as a blocked account.

141. Both sides agree that the label of "fixed" or "specific" (which I take to be synonymous in this context) cannot be decisive if the rights created by the debenture, properly construed, are inconsistent with that label. There is a fairly close parallel (first drawn, I think, by Hoffmann J in *Brightlife* [1987] Ch 200, 209 and often repeated) with the important distinction, in land law, between a lease and a licence: see the decision of this House in *Street v Mountford* [1985] AC 809. The distinction is clear in principle although landlords (in framing letting agreements) and banks (in framing debentures) may produce legal documents in a form which makes the principle difficult to apply. Whether or not it is appropriate to describe this by some disparaging term such as camouflage, it is the court's duty to characterise the document according to the true legal effect of its terms, as has been very clearly explained by Lord Millett in *Agnew* [2001] 2 AC 710, 725-726, para 32. In each case there is a public interest which overrides unrestrained freedom of contract. On the lease/licence issue, the public interest is the protection of vulnerable people seeking living accommodation. On the fixed/floating issue, it is ensuring that preferential creditors obtain the measure of protection which Parliament intended them to have. This public interest is unaffected by the changes in the classes of preferential creditors made by section 251 of the Enterprise Act 2002.

142. In my opinion Slade J did not, in *Siebe Gorman*, make any significant error in stating the general principles which apply. But he did not correctly construe the debenture which was before him in that case, and his decision on its construction has had surprisingly far-reaching consequences.

Siebe Gorman & Co Ltd v Barclays Bank Ltd

143. In his submissions on *Siebe Gorman*, Mr Moss QC mentioned that the judgment of Slade J was given after an eight-day trial. So it was, but that fact cannot by itself add weight to its authority. Only two pages of a 25 page judgment are directly concerned with whether the charge on McDonald's debts, although expressed in the debenture as a fixed charge, amounted in law to a floating charge. Slade J also had to resolve many disputed issues of fact, which were complicated by the death, before trial, of a key witness. He had to consider issues of

estoppel and rectification (though he did not ultimately have to decide those issues.) He did have to decide a difficult issue as to priority of charges (and his judgment on that issue may be the main reason why the judgment was reported). Of the 17 authorities cited, only three appear to have been cited on the issue of characterisation of the charge.

144. The key passage in the judgment of Slade J, at pp158-159, is set out in full in the judgment of the Master of the Rolls in this case, [2004] Ch 337, 376, para 72. I have already quoted part of it, with which the Crown has little or no quarrel. The crucial passage which the Crown does criticise is as follows (at p159):

> "I see no reason why the court should not give effect to the intention of the parties, as stated in clause 3 (d), that the charge should be a first fixed charge on book debts. I do not accept the argument that the provisions of clause 5 (c) negative the existence of a specific charge. All that they do, in my judgment, is to reinforce the specific charge given by clause 3. The mere fact that there may exist certain forms of dealing with book debts which are not specifically prohibited by clause 5 (c) does not in my judgment turn the specific charge into a floating charge.
>
> This conclusion that the charge is a specific charge involves the further conclusion that, during the continuance of the security, the bank would have the right, if it chose, to assert its lien under the charge on the proceeds of the book debts, even at a time when the particular account into which they were paid was temporarily in credit."

145. Mr Briggs QC, for the Crown, submitted that Slade J was wrong about the significance of clause 5 (c) of the debenture, which provided that during the continuance of the security McDonald

> "shall pay into the company's account with the bank all monies which it may receive in respect of the book debts and other debts hereby charged and shall not without the prior consent of the bank in writing, purport to charge or assign the same in favour of any other person and shall if called upon to do so by the bank execute a legal assignment of such book debts and other debts to the bank."

The judge saw this as reinforcing the specific charge given by clause 3 (that is, the "label"). Its real significance, in my opinion, was that it did not in any way restrict McDonald from taking the most natural course for a trader in the ordinary way of business, that is collecting the debts and paying them into its current account with the chargee bank. I agree with the criticism by Alan Berg, "Charges over Book Debts: a Reply" [1995] JBL 433, 445 that the judge's construction was based too much on linguistic considerations, in isolation from the matrix of facts in which the security was created.

146. When the debenture was granted, McDonald had a single current account which was overdrawn at the outset, with an overdraft limit (see [1979] 2 Lloyd's Rep 142, 146-7 summarised in paras 62 and 63 of the judgment of the Master of the Rolls). It is the proper characterisation of a charge at the time of its creation that is important, and the various manoeuvres which took place in the last few weeks before McDonald's final collapse (summarised in paras 65-69 of the Master of the Rolls' judgment) cannot be relevant to the issue of characterisation. For at least a year after the grant of the debenture, McDonald was free to use its overdraft facility to recycle its book debts in the ordinary course of its business. Slade J seems, with great respect, to have overlooked that that was the crucial point. The bank could decide to intervene and alter the banker-customer relationship. Indeed it did so by blocking McDonald's account about seven weeks before it learned of the winding-up petition. But under the charge~~s~~ as created there was no such restriction, either in clause 5 (c) or elsewhere. The last sentence of the criticised passage which I have set out above (beginning "This conclusion that the charge is a specific charge involves the further conclusion that . . .") was not, as its language makes perfectly clear, reinforcing the first conclusion with a second line of reasoning. It was drawing a further (incorrect) conclusion from the first (incorrect) conclusion.

Later authority

147. Like the Vice-Chancellor ([2004] Ch 337, 355, para 39) I feel the greatest hesitation and reluctance in disagreeing with a decision of Slade J. Indeed, the very high respect in which his judgments have always been held must have contributed to the enduring influence which *Siebe Gorman* has had. In their printed case Mr Moss and Mr Goldring assert that *Siebe Gorman* has been approved or accepted in many subsequent cases, and in England has not (until the Vice-Chancellor's decision) been held to be wrongly decided, or regarded as limited to its own facts.

148. That is very largely correct, although I do detect some inclination on the part of experienced Chancery judges to treat the decision as turning on a particular (and not fully explained) point of construction. That is my reading of Hoffmann J's observations in *Brightlife* [1987] Ch 200, 210 and of Lord Millett's observations in *Agnew* [2001] 2 AC 710, 727, para 38. In *In re Portbase Clothing Ltd* [1993] Ch 388, 396, Chadwick J made clear that he did not have to consider, and was not considering, whether *Siebe Gorman* was rightly decided. In the only English case in which *Siebe Gorman* was directly challenged, *In re A Company (No. 005009 of 1987) Ex p Copp* [1989] BCLC 13, the grounds of challenge were curiously oblique, no doubt in recognition of the fact that a first-instance Chancery judge would be very inclined to follow Slade J (as Knox J did) unless some point of distinction could be established.

149. In New Zealand *Siebe Gorman* has not been followed at first instance (the Court of Appeal of New Zealand found it unnecessary to decide this point): *Hoverd Industries Ltd v Supercool Refrigeration & Air Conditioning (1991) Ltd* [1994] 3 NZLR 300; [1995] 3 NZLR 577. In relation to a debenture in the *Siebe Gorman* form Tompkins J stated ([1994] 3 NZLR 300, 321):

> "It is my conclusion that a requirement to pay the proceeds of the book debts into the company's account without any restriction on how the company may use those proceeds does not give effective possession of those proceeds to the bank. It does not, without more, fasten the charge onto those proceeds. Supercool was free to deal with those proceeds except in the two respects stated, unless and until the BNZ intervened in a manner that would effectively inhibit that freedom."

I consider that that would be a correct statement of the position under English law.

150. A debenture in the *Siebe Gorman* form has also been considered by the Supreme Court of Ireland in *Re Holidair Ltd* [1994] 1 ILRM 481. *Siebe Gorman* was not cited. But the reasoning of Blaney J (with whom three other members of the court agreed) is compelling (at p493):

> "I am satisfied, accordingly, that the correct construction of the clause is that the trustee had a discretion to determine into what company account with what bank the proceeds of book debts should be paid from time to time. But there is no restriction in the clause on the companies drawing the monies out of these accounts. Accordingly, there is nothing in it to prevent the companies from using the proceeds of the book debts in the normal way for the purpose of carrying on their business. By reason of this the charge has also the third characteristic referred to by Romer LJ in his judgment in the case of *In re Yorkshire Woolcombers' Association Ltd* and is accordingly a floating charge and not a fixed charge."

151. In *In re New Bullas Trading Ltd* [1994] 1 BCLC 485, the Court of Appeal, differing from Knox J ([1993] BCLC 1389) upheld as a fixed charge a charge expressed as a fixed charge on book debts until they were collected, coupled with the requirement for them to be paid into a specified bank account (the chargee was not itself a bank) and a floating charge on the proceeds in the bank account. This decision was not followed by the Court of Appeal of New Zealand in *Commissioner of Income Tax v Agnew* [2001] 1 NZLR 223 (the headnote is mistaken in referring to the decision of the Court of Appeal in *New Bullas* as having been adopted; it was either distinguished or left in the air). *Agnew* then came on appeal to the Privy Council [2001] 2 AC 710, which upheld the Court of Appeal of New Zealand and in doing so strongly disapproved of *New Bullas*. Mr Moss has not sought to defend *New Bullas* and it may not be strictly necessary for your Lordships to express any view about it. But for my part I am sure that the Privy Council was correct in *Agnew*, and this House has already gone some way to approving *Agnew* in *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2002] 1 AC 336, 352. The essential fallacy in *New Bullas* has been explained by Professor Worthington in a note, "Fixed Charges Over Book Debts and Other Receivables" (1997) 113 LQR 562:

> "The categorisation of a charge over receivables requires examination of the permitted dealings with collected proceeds *only* in order to clarify whether the chargor is free to deal with the charged asset itself (the receivable) in the ordinary course of business without the consent of the chargee. This, and nothing else, is the hallmark of a floating charge."

The judgments below

152. Having covered most of the ground already I can set out quite shortly my views on the judgments of Sir Andrew Morritt V-C and the Court of Appeal [2004] Ch 337. The Vice-Chancellor held that *Siebe Gorman* was indistinguishable but wrongly decided. The Court of Appeal (Lord Phillips of Worth Matravers MR, Jonathan Parker and Jacobs LJJ) reversed the Vice-Chancellor in a single judgment of the Master of the Rolls with which the other members of the court agreed.

153. In my respectful opinion the Vice-Chancellor was correct on every point in his judgment except one, which does not present any obstacle to your Lordships (that is as to the relative authority as precedents of *New Bullas* and *Agnew*). On every point of substance I agree with the Vice-Chancellor's analysis and conclusions. In particular, I agree with his reasons for holding that *Siebe Gorman* was not distinguishable (p 347, paras 15 and 16):

> "Counsel for the bank points out that the observations of Slade J were directed to an account which was in credit. By contrast in this case the account was when opened and at all times thereafter in debit. He submits that the payment of the proceeds of a book debt into an overdrawn bank account prevents its further identification or tracing through such debit balance so that it cannot be contended that the company thereby enjoyed an unrestricted use of that book debt or of those proceeds. It is convenient to deal with this point at this stage.
>
> I do not think that any distinction is to be drawn for this purpose between the operation of an account which is in credit and the operation of one which is in debit but within the overdraft facilities agreed with the bank. The question is not whether the subsequent drawings by the company can be traced to or identified as the proceeds of a previous book debt but whether the charge when created contemplated that the company should continue to trade and should until the occurrence of some specified future event be free to use in such trade the class of asset described as book debts."

The Vice-Chancellor then referred to the classic statements in the *Yorkshire Woolcombers* case [1903] 2 Ch 284, 289 and *Illingworth v Houldsworth* [1904] AC 355, 357-358.

154. I also agree with the Vice-Chancellor's reasons for declining to follow *Siebe Gorman*. He referred to the critical passage in Slade J's judgment (which I have already set out) and observed (p 355, para 39):

> "But, as indicated in *Agnew's* case, the real question was whether the rights and obligations conferred and imposed by clause 5(c) disclosed an intention that the company should be free to deal with the book debts and withdraw them from the security without the consent of the bank. Such an approach to the provisions of clause 5 (c) of the debenture in the *Siebe Gorman* case must have led to the conclusion that the collection and free use of the proceeds of book debts through the ordinary operation of the bank account was not only permitted but envisaged. The inevitable consequence would be to reject the description of the transaction as a first fixed charge."

155. It follows that the Court of Appeal, although right on the doctrine of precedent, was in my view wrong to reverse the Vice-Chancellor on the issue of substance. I respectfully think that the Master of the Rolls was wrong in the broad ground of decision which he put forward at p 383, para 94 of his judgment. It has the attraction of simplicity and certainty but it approaches an essentially practical question (can the trader continue to use his circulating capital, including any credit available under an agreed overdraft, in the ordinary course of his business?) as if it were a technical question of tracing in equity. The Vice-Chancellor was right to reject that approach, as he did in the first passage which I have quoted from his judgment. I also think that the Master of the Rolls was wrong on the narrower issue of construction which he considered a little earlier in his judgment (p 382, para 93). I need not repeat my reasons for that conclusion.

Postcript: draftsmen's precedents and collateral transactions

156. Judges considering this area of the law have often commented on the convenience (in point of legal certainty) of using standard-form

clauses, the meaning of which has already been determined by the court. For instance Knox J observed in *Ex p Copp* [1989] BCLC 13, 25:

> "this is a type of transaction in respect of which judicial precedent is a particularly valuable guide to the commercial adviser. It is one of the main justifications for the doctrine of precedent that the adviser can, if he can rely on precedent, give reliable advice to his clients, and it is trite law that that is a particularly cogent consideration in regard to property transactions of one sort or another."

Requirements for particulars of floating charges to be registered publicly, and for a company's register of debentures to be open for inspection, suggest that Parliament intended that the existence and scope of any floating charge should be ascertainable by the general public, at least in theory (doubts as to how the system works in practice were expressed by Lord Hoffmann in the *Cosslett* case, [2002] 1 AC 336, 347-8, para 19).

157. These considerations might be thought to lead to the conclusion that everything relevant to the characterisation of a charge should be apparent on the face of the formal debenture, without further inquiry. That was, as I understand it, one of the reasons why Knox J, in *Ex p Copp*, declined to look at evidence about an agreed overdraft limit, regarding it as a "collateral arrangement". Knox J may have been right in his view that it was unnecessary to receive evidence about an overdraft limit (which may change from time to time) but he took the wrong approach as to the effect of the debenture itself, as the Vice-Chancellor rightly concluded ([2004] Ch 337, 355, para 40). The form of debenture showed that the recycling of book debts was "not only permitted but envisaged" and it contained no relevant restriction on that being done in the ordinary course of business.

158. In practice banks use printed standard forms of debenture in simple cases, and City solicitors no doubt have more sophisticated forms, suitable for very large transactions, in their word-processing libraries. It is most desirable that any form of secured debenture, whether simple or complicated, should contain all the terms necessary for its correct characterisation, without resort to any side-letters or other less formal documents (as in the Australian case of *Hart v Barnes* (1982) 7 ACLR 310, mentioned in *Agnew* at para 23). But the fact is that when a bank takes a charge there will normally be at least three

documents in play: the debenture creating the charge, the bank's facility letter offering a term loan or an overdraft, and the bank's general terms and conditions. Sometimes there will be more documents that are relevant. I would not rule out the possibility that in some (probably rare) cases all this documentation might have to be taken into account, in its proper commercial context, in determining whether a charge "as created" was a fixed or floating charge.

159. In one of the earliest cases on floating charges, *In re Florence Land and Public Works Co* (1878) 10 Ch D530, 537, Sir George Jessel MR said,

> "The question we have to decide must be decided, like all other questions of the kind, having regard to the surrounding circumstances under which the instrument was executed, and especially the respective positions of the parties who were the contracting parties, to carry out whose agreement that instrument was executed."

Cozens-Hardy LJ made similar observations in *Yorkshire Woolcombers* [1903] 2 Ch 284, 297. Many of the later cases have emphasised the need for the court to look at the commercial realities of the situation. The wish to achieve legal certainty by use of a standard precedent cannot override the need to construe any document in its commercial context.

160. It is also necessary to bear in mind Lord Millett's warning in *Agnew* [2001] 2 AC 710, 730, para 48, that formal provision for a blocked account is not enough "if it is not operated as one in fact." Lord Millett did not expand on this point, which may raise difficult questions as to what Staughton LJ, in *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148, 186-7, referred to as "external" and "internal" routes to the construction of commercial documents. This point is discussed in an article by Stephen Atherton and Rizwaan Jameel Mokal in (2005) 26 Company Lawyer 10, 16-18. These difficulties suggest to me that the expedient mentioned in the postscript to the judgment of the Master of the Rolls (para 99), although no doubt appropriate and efficacious in some commercial contexts, may not provide a simple solution in every case.

161. On the topic of overruling long-standing decisions which have been relied on by commercial lenders, and on the further topic of prospective overruling, I am in full and respectful agreement with the opinions of my noble and learned friends, Lord Nicholls of Birkenhead and Lord Hope. I would allow this appeal and hold, without any sort of temporal restriction, that *Siebe Gorman* was wrongly decided on the issue of construction.

BARONESS HALE OF RICHMOND

My Lords,

162. I agree that, for the reasons given in the opinion of my noble and learned friend, Lord Scott of Foscote, supplemented by those of Lord Hope of Craighead and Lord Walker of Gestingthorpe, the debenture in this case created only a floating charge. I also agree that that part of the decision in *Siebe Gorman & Co Ltd v Barclay's Bank Ltd* [1979] 2 Lloyd's Rep 142 which dealt with the effect of the debenture in that case should be overruled with the usual retrospective effect. In common with my noble and learned friend, Lord Nicholls of Birkenhead, and also Lord Hope, I would not wish to rule out the possibility that this House might one day consider that the only just result was to declare that its decision should have prospective effect only, including the possibility that this could arise in a dispute about the interpretation of a statute.

163. There is one other possibility that I would not wish to rule out. That is whether it might in future be decided that the Court of Appeal, or even the High Court, could decline to follow a previous decision of the Court of Appeal which has been expressly disapproved as part of the *ratio decidendi* in a case in the Judicial Committee of Privy Council on appeal from a country in which the law on the subject is the same as that in England and Wales. The Court of Appeal in *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1972] 1 QB 210 decided that it was possible. In *Davis v Johnson* [1979] AC 264, this House stated that the rule laid down in *Young v Bristol Aeroplane Co Ltd* [1944] KB 718, that with only three exceptions the Court of Appeal is bound by its own previous decisions, was still binding on the Court of Appeal, despite what Lord Diplock described, at p 325C, as the 'one-man crusade' of Lord Denning to free them from its shackles. This was in the context of a much more radical departure from the exceptions allowed in the *Young* case. *Worcester Works Finance* was not cited or

referred to in either the House of Lords or the Court of Appeal in *Davis v Johnson*. Privy Council decisions were not discussed in *Young*. We ourselves have heard no argument on the matter. I would hope, therefore, that nothing which is said in this appeal is taken to rule out the possibility that a further exception or qualification might exist or be developed along the lines indicated above.

164. In common with your lordships, I would allow this appeal and make the order proposed by Lord Scott.

LORD BROWN OF EATON-UNDER-HEYWOOD

My Lords,

165. I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Nicholls of Birkenhead, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give I too would allow this appeal and make the order proposed by Lord Scott. Whilst I would not rule out the possibility that this House may one day think it right to declare the law with prospective effect only, I am quite clear that this is not the case for such an order.