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Charges Over Bank Accounts in English Law

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Abstract[1**]

In this article, the author examines the English rules on charges over bank accounts. This article finds that: (i) under English law there were certain conceptual difficulties with regard to charges over bank accounts; (ii) it is unclear whether bank accounts are treated as book debts; (iii) a fixed charge over bank accounts constitutes a security financial collateral arrangement and exempts from registration; and (iv) a fixed charge over future book debts requires control over the proceeds deposited in the bank account and over the uncollected book debts.

Key words: Bank accounts; Conceptual difficulties; Book debts; Floating charges; Fixed charges

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1. CONCEPTUAL DIFFICULTIES WITH BANK ACCOUNT COLLATERAL

Various security interests are recognised under English law, including charges (both fixed and floating), pledges, mortgages[2] (both equitable and legal) and liens. Of particular interest to this article is the charge which grants an equitable proprietary interest in the secured asset. A charge is often used in relation to choses in action over book debts.

In relation to the focal point of this article then, when considering taking security over a bank account, it is inter alia necessary to ask the following two questions:

1) Is possible for the secured party to take a charge over its own indebtedness to the debtor?

2) Can a charge validly be taken over a fluctuating asset, which is not specific and sufficiently identifiable? (Hudson, 2015).

These questions will be analysed in further depth in the following.

1.1 The Relationship Between a Bank and an Account Holder

In the leading case *Foley v Hill*[3], Lord Cottenham LC noted that:

> "Money, when paid into a bank, ceases altogether to be the money of the principal; it is by then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. … That being established to be the relative situations of banker and customer, the banker is not an agent or factor, but he is a debtor."[4]

Accordingly, a deposit made by a depositor with a bank creates a creditor-debtor relationship between the depositor and the bank. A bank account is, therefore, a chose in action against the bank in the form of a loan for the amount deposited in the bank account (Hudson,

[1] The author thanks Jin Enyi (Advisor, Rooney Nimmo) for his kind help with this paper. Any errors or omissions are only attributable to the author.

[2] The essential distinction between a charge and a mortgage is whether an immediate right is granted over the secured asset (Hudson, 2015). In contrast to mortgages, "[c]harges [only] grant a right to seize property in the event that the chargor does not perform some underlying obligation." (Hudson, 2015) Unlike mortgages, charges do not involve a conveyance or assignment of title.

[3] (1848) 2 HLC 28; 9 ER 1002, p. 36.

[4] Ibid at para 36. See also *In re Spectrum Plus Ltd* [2005] 2 AC 680 at para. 60.

2015).[5] It follows from this that the term 'charge over cash' in this regard would strictly speaking be a misnomer since a charge would not be taken over the deposited money as such, but rather the bank's contractual obligation to repay the deposited money. It is also worth noting that there are cases where a bailment is created, rather than a creditor-debtor relationship. This is typically the case with special accounts where (i) the deposited cash is secured and isolated from the bank's own funds; and (ii) the title to the deposited cash is not transferred to the bank. This would result in the bank being unable to commingle and use such deposits.

1.2 Dual Roles as the Secured Party and the Account Debtor

Financing arrangements where a lending bank takes a charge over its own debt/the customer's cash deposit are generally referred to as 'charge backs' (Benjamin, 2000). A seemingly controversial issue in relation to security transactions which includes a bank account is whether the secured party (i.e. the chargee bank) and account debtor (bank) can be identical.

It has been held "conceptually impossible" for a debtor to grant a charge over the debtor's own debt to the charger.[6] This was mainly reasoned on the point that "[a] debt is a chose in action; it is the right to sue the debtor. This can be assigned or made available to a third party, but not to the debtor, who cannot sue himself."[7] In other words, the position of such view would be that a security granted in this fashion would violate the traditional principles of common law relating to a chose in action which is a claim against someone other than the obligor. (Benjamin, 2000). This view was challenged in *Re Bank of Credit and Commerce International SA*[8] by Lord Hoffmann who, upon examination of the nature of an equitable charge, found the security interest over a bank account consistent with the normal features of an equitable charge, and held it could validly be made. He noted that:

> "An equitable charge is a species of charge, which is a proprietary interest granted by way of security. Propriety interests confer rights in rem which, subject to questions of registration and the equitable doctrine of purchaser for value without notice, will be binding upon third parties and unaffected by the insolvency of the owner of the property charged. … A charge is a security interest created without any transfer of title or possession to the beneficiary."[9]

With regard to the issue noted by Millett J that "[t]he debtor [bank] cannot, and need not, resort to the creditor's claim against him in order to obtain the benefit of the security; his own liability to the creditor is automatically discharged or reduced."[10] Lord Hoffmann held that "[t] he general rule is that a secured creditor is not obliged to resort to his security. He can claim repayment by the debtor personally and leave the security alone."[11] He further noted that "[t]he method by which the property would be realised would differ slightly: instead of the beneficiary of the charge having to claim payment from the debtor, the realisation would take the form of a book entry."[12] This would not lead to the bank having a claim against itself. The judgement was followed in *Fraser v Oystertec Plc.*[13] In view of this, charge back arrangements are arguably not invalid simply because the chargor takes the roles of both security holder and the account debtor, as the realisation would take the form of a book entry.

1.3 Bank Account Value Fluctuation

Bank account collateral may have a fluctuating value making it a risky form of security. The issue is addressed by creating a fixed charge allowing the chargee bank to retain control during the loan period.

Under English law, a charge is classified either as a fixed/specific charge[14] or a floating charge. In *Illingworth v Houldsworth*[15], Romer LJ identified three characteristics of a floating charge:

1) the charge is not attached to any specific asset, but to a pool of assets owned by the chargor, present and future;

2) the charged assets may change in the ordinary course of the chargor's business; and

3) the chargor may deal with the charged assets freely until crystallisation occurs.[16]

As noted in *Agnew v Inland Revenue Commissioner*, among these characteristics, the essential feature of a floating charge is the third one.[17] That is, the chargor's right to (on his own account) deal with the charged assets without reference to the chargee until crystallisation

[5] A loan is a personal, bilateral, and direct lending obligation between one or more lenders (the latter typically being a syndicated loan). This differs from a debt security which is a transferable certificate for equivalent debt (Hudson, 2013). Securities are either registered or unregistered (i.e. payable to the person holding it or presenting it), and security transactions will typically be more complex than loan deals.

[6] *Re Charge Card Services Ltd* [1987] Ch 150 per Millett J.

[7] *Re Charge Card Services Ltd* [1987] Ch 150, 176.

[8] (No 8) [1998] AC 214.

[9] *Re Bank of Credit and Commerce International SA* (No 8) [1998] AC 214, p. 226.

[10] *Re Charge Card Services Ltd* [1987] Ch 150, 176.

[11] *Re Bank of Credit and Commerce International SA* (No 8) [1998] AC 214.

[12] ibid at p. 226.

[13] [2006] 1 BCLC 491.

[14] As noted by Lord Scott of Foscote, "[t]he 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.", see *In re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680 at para. 79. Where the term "specific charge" is used in this article, it refers to a fixed charge.

[15] [1903] 2 Ch 284, pp. 294-5.

[16] *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284, cf *Royal Trust Bank v National Westminster Bank plc* [1996] BCC 316.

[17] [2001] 2 AC 710. See also (Worthington, 1997).

occurs is what distinguishes a fixed charge from a floating charge.

Of particular interest to this article then is the risk of recharacterisation of a fixed charge. *In re Spectrum Plus Ltd*[18] a charge was expressed as a 'specific charge', yet the charge granted over the bank account did not amount to a fixed charge. This was because the chargor in the course of ordinary business could draw upon it at will without requiring consent from the chargee. It thereby follows that the label of a charge is of less importance in comparison to the actual rights conferred. This would also mean that if there is no requirement in a security agreement over a bank account for the proceeds to be paid into a segregated and blocked account (or if such a requirement exists and it is not followed), the charge will risk being (re) characterised as a floating charge.[19]

2. CHARGE ON BOOK DEBTS

The question is here whether a charge over positive cash accounts balances amounts to a charge on a book debt. In *Re Charge Card Services Ltd*[20] Millett J found that a charge back arrangement would not be effective as a security interest, but as a right of set off, and thus not required to be registered. In *Re Brightlife Ltd*[21], Hoffmann J held that:

> "A credit balance at the bank cannot sensibly be 'got in' or 'realised,' and the proviso cannot therefore apply to it. If 'book or other debts' includes the bank balance, the consequence is that [the company] could not have dealt with its bank account without the written consent of [the bank]. It would have had to obtain such consent every time it issued a cheque. The extreme commercial improbability of such an arrangement satisfies me that the parties used "book debts and other debts" in a sense which excludes the credit balance at the bank."[22]

This was confirmed in *Northern Bank Ltd v Ross*[23] whereby money in the bank accordingly "… cannot be regarded as being within the meaning of the term 'book debts and other debts'."[24] Moreover, the term 'cash at bank' includes all monies in a bank account regardless of whether or not the bank account is used as a trading account, and whether or not the company is carrying out business without withdrawing from the bank account.[25]

These two authorities have in general terms been questioned in *Re Bank of Credit and Commerce International SA*[26] by Lord Hoffmann who found that the banks themselves were entitled to decide whether deposits charged would be categorised as book debt. Instead, he referenced *Northern Bank Ltd v Ross*[27], simply noting that "… in the case of deposits with banks, an obligation to register is unlikely to arise."[28]

In summary, it is uncertain from English case law whether bank accounts amount to book debts. However, According to the Financial Collateral Arrangements (No 2) Regulations 2003[29], article 4(4), a 'security financial collateral arrangement' will be exempted from registration. The core requirement of this arrangement will be the cash should be in the possession or under the control of the lending bank or a custodian acting on its behalf.[30] This point is clarified by the new regulation that the possession of the collateral includes the cases where financial collateral has been credited to an account in the name of the collateral-taker or a person acting on his behalf.[31]

A fixed charge over a cash deposit constitutes a security financial collateral arrangement (Pierce, Drake & Hewitt, 2016). This is structured with the use of a blocked account (Proctor & Tether, 2011). Proctor and Tether notes that:

> "… apart from possible sensitivity about the impact of negative pledge undertakings in other financing documents, the mere fact of registration of such an arrangement may have an adverse impact on the customer's credit standing and may, for example, in some cases result in a tightening in supplier terms of payment." (Proctor & Tether, 2011)

The borrower will, therefore, be reluctant to register security interests over bank accounts. It remains unclear whether a floating charge falls under the registration exemption or not (Pierce, Drake & Hewitt, 2016). As noted by Pierce, Drake and Hewitt, since a purported fixed charge may be at risk of being recharacterised as a floating charge by the courts, a prudent banker should in practice register a security over a bank account, regardless of it being a fixed charge or a floating charge (Pierce, Drake & Hewitt, 2016).

3. FUTURE BOOK DEBTS

As to charges over future book debts, case law has been concerned about the distinction between situations where such charges amount to fixed charges or floating charges (Hudson, 2015). An important question is whether the

[18] [2005] 2 AC 680.
[19] *Re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680 and *Agnew and Another v Commissioner of Inland Revenue* [2001] UKPC 28; [2001] 2 AC 710.
[20] [1987] Ch 150, p. 177.
[21] [1987] Ch 200.
[22] Ibid 209.
[23] [1990] BCC 883 per Lord Hutton LCJ.
[24] Ibid 887.
[25] Ibid 889.
[26] (No 8) [1998] AC 214.
[27] [1990] BCC 883.
[28] Ibid p. 227.
[29] SI 2003/3226, as amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010 (SI 2010/2993).
[30] Financial Collateral Arrangements (No 2) Regulations 2003, article 3
[31] The Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010, article 4

charge holder can take a fixed charge over uncollected book debts, whilst taking a floating charge over the proceeds in the bank accounts.

In *Re Brightlife Ltd*[32] Hoffman J (as he then was) found that it would amount to a floating charge if the chargor could use a credit account, rather than a special account to "… receive money and in respect of debts owing to it and doing so in the ordinary course of getting in debts", though the chargor was not entitled to deal with the collected debts.[33] In other words, if it is permitted that the proceeds of the book debts are paid into a general account, and payments out of such account do not require the chargee's consent, a charge over future book debts will constitute a floating charge. In *Re New Bullas Trading Ltd*[34], it was held that with regard to future book debts:

> "[t]here being usually no need to deal with it before collection, it is at that stage a natural subject of the fixed charge. But once collected, the proceeds being needed for the conduct of the business, it becomes a natural subject of the floating charge."[35]

Noursely LJ further noted that it is open to the contracting parties "… to provide that they shall be subject to a fixed charge while they are uncollected and a floating charge on realisation".[36] This view was not followed in *Agnew v Inland Revenue Commissioner*[37], where it was held that "[w]hile a debt and its proceeds are two separate assets, however, the latter are merely the traceable proceeds of the former and represent its entire value."[38] Consequently, if the proceeds can be used without any restraints on the chargor, a charge over future book debts should be classified as a floating charge. This is what Lord Millett observed on the essential distinction between a fixed charge and a floating charge, as mentioned above. The view was confirmed by the House of Lords in *Re Spectrum Plus Ltd*[39].

In brief, under English law, if expecting to take a fixed charge over future book debts, banks should ensure control by imposing restrictions on the borrower's use of the monies in the bank account. Although this can be difficult, cumbersome, and regarded as commercially impractical, such restrictions must be imposed as to avoid the recharacterisation risk.

CONCLUSION

This article has analysed charges over bank accounts in the UK. Under English law, it is possible to take charges over bank accounts by taking either a fixed charge or a floating charge, although there were conceptual difficulties. However, as noted by Lord Hoffmann "… the courts should be very slow to declare a practice of the commercial community to be conceptually impossible."[40] Whether bank accounts are book debts is unclear from English case law. This is important with regard to the registration requirements under current English law. There is no registration requirement for fixed charges, but it remains unclear whether a floating charge over positive cash account balances amounts to a charge on book debt that needs to be registered. Consequently, if the monies deposited in the secured bank accounts are the proceeds of future book debts, banks should ensure control of these to avoid the recharacterisation risk.

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[32] [1987] Ch 200.
[33] Ibid 204.
[34] [1994] BCC 36.
[35] [1994] BCC 36, p. 3.
[36] Ibid p. 7.
[37] [2001] UKPC 28; [2001] 2 AC 710.
[38] [2001] UKPC 28 para. 46.
[39] [2005] 2 AC 680.

[40] *Re Bank of Credit and Commerce International SA* (No 8) [1998] AC 214, p. 228.