Chapter 1: Introduction

In the second half of the 19th century, the courts of equity in England recognized a new type of charge, named a "floating charge". Ever since then, the English differentiation between fixed and floating charges has had multiple implications. This distinction is used in the territories that were influenced by English law, including Israel. A floating charge in Israel differs in certain respects from its English forefather, especially with regard to the prohibition on the chargor company to perform various transactions without prior consent from the chargee. But this is beyond the scope of this paper.

The criteria recognized in England for the distinction between a fixed and a floating charge have also been recognized by Israeli case law. Under the leading English case, National Westminster Bank plc v. Spectrum Plus Ltd, a charge shall be deemed fixed if the creditor has control over the charged assets. If the debtor is entitled to freely trade in the charged assets and charge other assets to the creditor in their stead, this is considered a floating charge. For example, if the debtor company created a charge over its accounts receivable in favor of the bank which manages its account, and under the debenture, the money received from the company's customers is deposited into a designated account and the chargor is entitled to withdraw money from this account up to an agreed limit, then this is considered a floating charge. On the other hand, if various restrictions are imposed on withdrawals, such control by the bank over the charged assets would classify this as a fixed charge. This distinction has important implications for the classification of a charge on a securities account.

In Israel, as in England, it is standard practice that floating charges apply only to companies, and that they cannot apply to the assets of an individual. This has been the rule followed in the last 45 years, which was when the only single precedent on this matter was delivered. At the time, Israeli law did not recognize that a security interest over the assets of an individual could be created by registration, and only recognized a pledge where the charged asset was placed in the creditor's possession. Against this background, a floating charge on the assets of an individual could not be recognized. Until recently, the old rule was never revisited, although the 1967 Security Interest Law recognized a registered
security interest over the assets of an individual. In the early 1980s, the Ministry of Justice appointed a committee to look into this subject. The committee's recommendation was to maintain the status quo and not to recognize a floating charge over the assets of an individual.

This assumption was recently put to the test in the various stages of Atzmon v. The Estate of Bar Levav. Mr. Bar Levav had an antiques store in Jerusalem, and borrowed money from various sources. In a debenture in favor of one of his creditors, the charged asset was described as follows: "All the contents of the Ancient Coin store in Jerusalem as at this date and from time to time... are hereby placed under a floating charge, including ancient coins, medallions, pottery... ". Bar Levav charged his business inventory to another creditor. The term "floating charge" was not used anywhere in this debenture. Both charges were registered with the Registrar of Security Interests. Either the Registrar thought he could register a floating charge over the assets of an individual, or was not aware that this was precisely what he was doing. Bar Levav passed away, and the executor of his estate moved to have the charge declared void, since no floating charge can be placed over the assets of an individual.

This case was heard four times. The Magistrate's Court held that the charge was invalid. On appeal, the District Court upheld the charge, citing primarily the freedom of contract. The District Court held that contracts must be honored and that as long as it did not violate any law, morals or public policy, the debenture should be honored. The Supreme Court nullified the charge, setting aside the judgment of the District Court. A petition for a special hearing was denied. Eventually, then, the old precedent was upheld, and the longstanding assumption whereby a floating charge cannot be created over the assets of an individual, was reaffirmed.

The second chapter of this paper shall review the approach of other legal systems to this subject. Specifically, we shall review the law in England, the United States and Canada. In the third chapter we review Israeli statute with respect to security interests, and consider whether the statute reflects a deliberate position on the subject at hand. The fourth chapter addresses the substantive arguments for and against recognizing a floating charge over the assets of an individual. The fifth chapter offers a summary and an outlook into the future.

Chapter 2: Floating Charge Over the Assets of an Individual—Comparative Analysis

A floating charge implies several assumptions: (1) It covers after-acquired property, namely—assets which the chargor does not yet own at the time of executing the debenture. (2) The creditor must allow the debtor to sell the charged assets, such that the rights of any purchaser shall be free and clear, even if such purchaser was aware of the charge. (3) There is no conflict between a sweeping license to sell charged assets and the existence of a charge. These three assumptions can hold just as well with respect to an individual. An individual is entitled to create a fixed charge over a specific after-acquired asset. Also, if the secured creditor and the debtor agree that the charge shall expire if and when the
debtor sells the asset to a third party, there is no reason to deny the validity of such agreement, which reflects the intention of the parties and has no adverse effect on third parties. The statement that there is no conflict between a sweeping license to sell the charged assets and the very existence of a charge, is just as strange, at first glance, with respect to a company as it is with respect to an individual. The assumptions on which a floating charge is based, are therefore not unique to a company, and, at least in theory, there is no reason not to apply floating charges to assets of individuals as well.

Indeed, the reason why English courts have not recognized a floating charge on the assets of an individual, is unrelated to the nature of a company as compared to that of an individual. The origins of these rulings are technical rather than substantive, and arise from the specific language of the statute. The Bills of Sale Act 1878, as amended in 1882 governs the transfer of title to chattel, including by charges. Under this Act, a debtor who charges personal chattels must provide a detailed description of the charged assets. The Act does not apply to charges created by companies. This enabled the Courts of Equity to recognize a company's debenture, even if the chattels were only generally described in the debenture instead of specifically described as the Act requires. As mentioned, in order to create a charge over the assets of an individual, the individual must annex to or write on the bill of sale a schedule containing an inventory of the personal chattels comprised in the bill. Therefore, an individual cannot create a floating charge over his assets.

The floating charge in its English form, does not exist in two of the major common-law jurisdictions: the United States and Canada. The U.S. never adopted the English floating charge to begin with. Canada recognized it originally, but abolished this institution later on. Instead, these legal systems recognize a security interest known as a "floating lien", which makes no distinction between individuals and corporate entities, and comprises the following elements: (1) the lien applies also to after-acquired property; (2) the lien applies also with respect to future advances; (3) a purchaser in the ordinary course of business receives good title to the purchased goods, free from the lien; (4) subject to specific exceptions, upon registration of the lien, the secured creditor shall have priority over other creditors.

The elements of the American and Canadian floating lien are similar to that of the English floating charge. However, these jurisdictions recognize only one type of a security interest. In addition, as mentioned, the floating lien applies to a company and to an individual alike. This saves court resources, since no time needs to be spent on deciding how to categorize the lien. Developing this point is beyond the scope of this paper. The relevant point for this paper is that we have empirical proof that a security interest, whose elements are similar to those of the English floating charge, can be applied to assets of an individual.

Chapter 3: The Laws Relating to Security Interests
In this chapter we shall consider whether the law in Israel recognizes a floating charge over the assets of an individual. As we shall see later on, the statute is silent on this matter, so we will analyze whether the law recognizes such a charge implicitly. In this chapter I relate to the current situation. The question whether the law should recognize a floating charge over the assets of an individual, shall be dealt with in the fourth chapter. The ambiguity of the law creates a link between the subjects of these two chapters, namely, the analysis of the law as it is and as we believe it should be. For example, if policy considerations lead us to conclude that a floating charge over the assets of an individual should not be allowed, we can also interpret the law to read as such.

If we conclude that the statute does not recognize a floating charge over the assets of an individual, then the courts probably have no discretion to do so either. A floating charge is a property right, because it gives the chargee priority over the debtor's unsecured creditors. It is a basic principle of property law, that a right can be enforceable against third parties only if it is made public, so that such third parties can be made aware of the existence of such right, and plan their actions accordingly. This is why many legal systems, including in Israel, follow the *numerus clausus* principle, and the courts are not free to recognize as property rights any right that is not recognized as such by statute. The following statement of the District Court in *Bar Levav* must therefore be taken carefully: "Israeli law recognizes a floating charge in corporate law. The law is silent with respect to individuals, but silence is not tantamount to prohibition. Inference can be drawn from the company to the individual." If the statute is silent and case law nonetheless recognizes the right, this means that a new right in property is created by contract, in contravention of the *numerus clausus* principle.

Israeli law draws a distinction between charges on assets of an individual and charges on assets of a company. Charges on the assets of individuals are governed only by the 1967 Security Interests Law, whereas charges on assets of companies are governed also by the 1983 Companies Ordinance [New Version]. The Companies' Ordinance was enacted in Palestine in 1929 under the British Mandate government, and it is a copy of the companies' law as it was then in effect in England. In 1983, Israel adopted a new version of the Ordinance. In 1999, Israel adopted a modern companies' law, but this statute did not cover charges on assets of a company. Therefore, the provisions of the Ordinance on this matter still apply. The relationship between the Security Interests Law and the Companies Law is that of *lex specialis* and *lex generalis*. Therefore, a charge over the assets of a company is subject to the general terms of the Security Interests Law, unless the Companies Law stipulates otherwise. As stated, a charge over the assets of an individual shall be subject solely to the provisions of the Security Interests Law.

The special provisions in the Companies Ordinance relate mainly to two subjects: the Registrar of Charges and a floating charge. Under the Ordinance, charges created by a company are to be registered with the Registrar of Companies, not with the Registrar of Security Interests. The registration provisions prescribed under the Companies' Ordinance differ from those applicable to security interests
over assets of individuals. The Companies Ordinance stipulates several provisions with respect to a floating charge, such as: the relationship between a floating and a fixed charge (Section 169); the requirement that the charge must be registered in order to give it effect against third parties (Section 178); the priority of certain preferential debts, such as debts to employees and tax debts over any floating charge (Section 354); and the possibility to void a floating charge that was created during the six months immediately prior to the company’s liquidation (Section 359).

The term “floating charge” is mentioned only once in the Security Interests Law. Section 26(b) stipulates: “The provisions hereof shall not prejudice any law regarding a floating charge over the assets of an individual.” This stipulation is strange. If the Security Interests Law applies solely to specific charges, then this stipulation is redundant, because in any event, the Security Interests Law has no effect on the laws of the floating charge. It therefore seems that the legislator was of the opinion that the Security Interests Law applies to floating charges too, and that therefore it was necessary to stress that the provisions of the Security Interests Law do not prejudice those of the Companies’ Ordinance with respect to floating charges.

The same conclusion is echoed in case law, which has applied various provisions of the Security Interests Law, to floating charges over the assets of companies. First, the courts applied to floating charges provisions from the Security Interests Law regarding the realization of the charge. This is not problematic, because the charged assets are only realized after the charge has crystallized, once the floating charge has already transformed into a fixed charge. Later case law went one step further, applying to floating charges provisions of the Security Interests Law that relate to the creation of the charge. "There is no doubt that the floating charge is a security interest in the meaning of Section 1(a) of the Security Interest Law," the court said in one of these instances. The Security Interests Law defines a security interest as "the charge of an asset…” and the courts have applied this definition to a floating charge, which does not relate to a specific asset but rather to a class of assets. However, the courts have been selective in their implementation of the provisions of the Security Interests Law on floating charges of company assets. For example, the court has held that Section 5 of the Security Interests Law, which contemplates a market overt rule in favor of secured creditors, does not apply to floating charges, because the protection granted by this rule is too sweeping for the case of a floating charge. As decided by the court, the rule of market overt shall protect a creditor holding a specific charge, but not a creditor who has a floating charge.

Since the courts have held that the Security Interests Law applies to a floating charge created by a company and that the term "security interest” also includes a floating charge, there is no logical reason not to recognize a floating charge over the assets of an individual. According to this approach, a floating charge created by a company shall be governed by two sets of rules: the Companies Ordinance and the Security Interests Law, whereas a floating charge created by an individual shall be governed only by the Security Interests Law. However, even if the Security Interests Law recognizes a floating
charge over the assets of an individual, many questions remain unanswered. For example, under Sections 4 and 6 of the Security Interests Law, the holder of a registered charge has priority over an unsecured creditor and over subsequent secured creditors. Does this mean that a floating charge over the assets of an individual is preferred over a later specific charge, even if the debenture creating the floating charge does not prohibit the chargor from transacting in the charged assets? Another question may arise with respect to the scope of the charge. A floating charge can be created with respect to all of the assets of the chargor company, or with respect to a certain category of assets only, such as negotiable instruments or securities. It is not clear whether both options are open to individuals as well. If an individual is permitted to create a charge over all of his assets, the chargee might have a receiver appointed over all of these assets. Since a receivership does not afford the same favorable mechanisms of a trustee in bankruptcy, this would adversely affect the liberty and dignity of the individual chargor.

A proactive approach would use the Companies' Ordinance as a source for creating new precedents, by inference from a floating charge over the assets of a company to a floating charge over the assets of an individual. I believe that, given the numerous issues illustrated above, the court should not recognize floating charges over assets of individuals and should leave this matter to a thorough review by the legislator. In a previous paper, I have already explained why the Security Interests Law applies to a floating charge over the assets of a company only once such charge has crystallized and has thus become a fixed charge. This line of thinking obviously leads to the conclusion that the Security Interests Law cannot be read as recognizing a floating charge over the assets of an individual.

Chapter 4: Policy Considerations—For and Against Recognizing the Charge

4.1 General

In Chapter 3, I expressed my view that before a floating charge over the assets of an individual can be recognized, the matter must be comprehensively reviewed, and that this is a matter for the legislator. In Chapter 4, I shall analyze the main factors that the legislator should take into account in its deliberations. These factors have all been discussed in the various stages of the Bar Levav case, by the 1982 committee and in the literature.

Two main factors support recognition of a floating charge with respect to individuals: consistency with other laws which recognize transactions in after-acquired property, and an increased amount of credit on the market that will stem from such recognition. Four main reasons have been cited against recognizing a floating charge over assets of an individual. First, it has been said that there is little demand in the credit market for floating charges over the assets of individuals. Another reason underscores the high cost of controls, as compared to the value of the assets of most individuals. The rationale here is that individuals do not maintain comprehensive records, and creditors would find it difficult to know the value of an individual's assets unless they implement costly controls. Because of
these costs, appropriate controls will not be implemented, and the effectiveness of the floating charge shall be eroded. This reason is related to the first one, and might explain why there is little market demand for such charges. The opponents of recognizing a floating charge over the assets of an individual are also concerned that banks would manipulate this option by demanding a floating charge from many individuals. Unsecured creditors would then be at an even more inferior position than they already are today.

A social reason has also been cited against recognizing a floating charge over the assets of an individual. Bankruptcy laws are designed to pool together the assets of the bankrupt individual and divide them among his creditors, but are also designed to protect the debtor. The bankruptcy process is intended to finalize all claims against the debtor and enable him to start with a clean slate. Once the bankruptcy process has been completed, the debtor has no assets, but no debts either, and can find a job and break even. From this perspective, a company and an individual are not the same. When a company encounters financial difficulties, the law gives it time to implement a recovery process, and protects it against creditors. However, if the recovery plans fail, the company will enter into liquidation. The law has no reason to keep intact a company that is not financially viable. At the same time, it is the duty of the law to protect an individual such that after his assets are divided among his creditors, he can still rebuild his life and not become a burden on the taxpayers. This is why the law exempts the debtor from any obligation with respect to debts that pre-date the bankruptcy process. In our context, it has been argued that a floating charge would mean that no such "clean slate" would be possible, because the charge would also apply to assets acquired after completion of the bankruptcy process, and a secured creditor is entitled to exercise his charge even after a bankruptcy order has been issued against the debtor.

I feel that most of these reasons are not compelling. The argument that the law recognizes transactions in after-acquired property in other fields, and that recognition of a floating charge over the assets of an individual would be consistent with this trend, is lacking. An appropriate analysis would consider whether with respect to individuals, there are reasons that justify not recognizing a floating charge. In addition, as mentioned, the main novelty that a floating charge introduces, is not the fact that it also applies to after-acquired property, but rather that a sweeping license to sell the charged assets does not conflict with the very concept of a charge. The converse argument regarding the absence of market demand, is also not convincing. First, it is impossible to say how many small businesses have incorporated solely in order to satisfy the demand of a bank or another creditor to grant a floating charge. It is also possible that the low demand is precisely because the law does not allow a floating charge over the assets of an individual. If the law is changed, market practices might change as well.

I feel that the explanation regarding relatively high costs of control with respect to the assets of an individual, due to the small scope of assets and the fact that individuals do not keep accurate records, cannot justify a prohibition of floating charges for individuals. This alternative should be open to
creditors and debtors. Anyone who is concerned that because of the control problem, the charge would not be effective, can opt for a fixed charge. The social concern is noteworthy, but can be addressed easily. Simultaneously with recognizing a floating charge for individuals, the bankruptcy laws should be amended such that a floating charge shall not apply to assets that an individual debtor has purchased after conclusion of the bankruptcy process.

In my opinion, it is in the best interest of both creditors and debtors to permit floating charges over the assets of individuals, albeit with certain restrictions with respect to consumer goods. This would increase the amount of credit available to small businesses and to individuals, as explained in the following paragraphs.

4.2 More Financing for Small Businesses

An individual who needs a loan, can offer various assets as a security. The borrower may mortgage his dwelling or other real estate that he owns, his car, or a money deposit he has in the bank. Most people hold onto such assets for years, and it is quite simple to create a fixed charge over them. Should the borrower wish to transfer his rights in the charged asset, he can repay his debt to the secured creditor and have the charge removed, or charge another asset against the release of the original security. With respect to individuals, I believe there is only one asset, a securities account maintained with a member of the stock exchange, which may be difficult to submit to a fixed charge. The difficulty is because in such accounts, the chargor is usually allowed to replace the securities in his account with other securities, provided that the overall value of the securities in the account does not fall below an agreed sum.

An individual's business may have an inventory. A business inventory is an ever-changing asset in the ordinary course of business, the debtor sells various products and purchases others in their stead. The only way to use a business inventory as a security, is through a floating charge. A fixed charge on the inventory would mean that the inventory cannot be sold, which would have an adverse effect on debtor and creditor alike. In addition, a fixed charge cannot be created over a business inventory, because the charged inventory has no specific markers with which it can be identified. An inventory usually consists of thousands of identical, production-line items that cannot be told from one another. A general description of the type of asset that is charged as a security, e.g., "corn seeds" or "toys", is appropriate for a floating charge but not for a fixed charge. If the owner of a business that is not a corporate entity has no legal way to create a floating charge over his inventory, such business owner shall find it difficult to obtain credit. Financial institutions such as banks, do not normally extend credit without a security against it. Credit is key to modern economics, and in order to facilitate access to credit, the scope of assets available for charges should be extended. A small business should not be forced to incorporate, causing it the various related expenses, only so that such business can create a
floating charge. If the business owner can offer his inventory as a security for a floating charge, his ability to obtain financing will increase.

A floating charge on all of the assets of a company grants the secured creditor two major advantages. One is the priority. A floating charge which restricts the chargor company from transacting in the charged assets, which is the form of the modern floating charge, still grants priority over the company's unsecured creditors and over later chargees who have a fixed charge over any specific asset of the company. The floating charge offers another advantage, because it allows a chargee that has not been repaid, to file motion with the court to have a receiver appointed for all of the company's assets. The holder of a floating charge can therefore decide whether to have the company's management replaced by a receiver on his behalf.

Over the last 30 years, it has often been said that the floating charge is too strong. For example, it has been said that the prohibition on later transactions gives the holder of a floating charge a financing monopoly, which pushes up the price of credit. The concern is that the chargee would not permit the chargor to create additional charges over its assets, and the chargor would then find it difficult to raise financing from other sources. Without competition, the price of credit would rise. Another critique is that a floating charge traditionally applies to all of the company's assets. This extensive reach leaves unsecured creditors with very little dividend on their debts.

Given the above, the popular direction now is to reduce the strength of the floating charge. In Israel, this has been reflected in the grant of legislative priority to a purchase money security interest over a previously-existing floating charge. The reduced strength of the floating charge is also reflected in a recent court decision, whereby the floating charge shall have priority over a later fixed charge, only from the time when the restriction concerning later transactions was actually registered with the Companies' Registrar, and not from the time that the Registrar received the application for such registration, as was the practice until now. In England, the clipped power of the floating charge is reflected in the Enterprise Act 2002, which allocates to ordinary creditors a portion of the proceeds of liquidation of the company's assets.

Allowing individuals to create a floating charge would ostensibly conflict with this trend. However, I believe that this is no reason to permanently adhere to the illogical discrimination between individuals and companies. The scope of a floating charge should be limited in other ways, by allocating a portion of the proceeds of liquidation to the unsecured creditors.

Chapter 5: Summary and Look-Ahead
The rejection of the petition for a discretionary appeal in *Bar Levav* ended the judicial review of the matter of floating charges over assets of individuals. Now, any change in the law must come from the legislator, but without market pressure, the chances of any such amendment are slim to none. Such a change is more likely to occur as part of a comprehensive revision of Israel's security interest laws.

In January 2010, the Israeli Justice Ministry published a memorandum for the 2010 Security Interests Law, which is to replace the statute that has been in effect since 1967. The new legislation is based on the principles of Article 9 of the Uniform Commercial Code of the U.S.A.; The language and details of the new law are based on the Personal Property Security Acts of the Western provinces of Canada.

This memorandum abolishes the current distinctions between charges over the assets of individuals and corporate entities. Any debtor, whether an individual or a corporate entity, can create a charge over all of its assets. The notice of registration of such charge can be delivered to the Registrar of Charges before the debenture is signed, and may include a general, rather than specific, description of the asset serving as a security, e.g., "business inventory", "accounts receivable", or "all the assets of the debtor". The principles underlying the memorandum are as follows: The collateral can also secure future advances, and shall also apply to after-acquired property, with the exception of consumer goods. The debtor may transact in the charged assets, even if the debenture prohibits this, and the security interest shall attach to the proceeds of the original asset. The main priority principle is the first-to-file rule, whereby, subject to certain exceptions, the first creditor to register his rights have priority. Due to these characteristics, this type of charge is known in the U.S. and Canada as a "floating lien". Despite the many similarities, the American-Canadian floating lien that is proposed in the memorandum, differs from the English floating charge that exists in Israel to date. The new bill does not recognize two types of security interests, and there will be no need, even in different contexts such as when negotiable securities or goods in a bonded warehouse serve as securities, to determine whether the charge is floating or fixed.

In my opinion, the draft is currently lacking, and requires much work before it can be put before the Knesset, the Israeli parliament, for a vote. It is therefore impossible to speculate if or when this bill will be passed into law. Therefore, until a comprehensive revision of the security interest laws, the rule fixed in *Bar Levav* will apply, and in Israel, an individual will not be able to create a floating charge over his assets.