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Supreme Court clarifies distinction between fixed and floating charges

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Introduction

The Supreme Court of Israel recently clarified the distinction between fixed and floating charges under Israeli law. While the decision of the Supreme Court did not specifically address charges on intellectual property (IP), the tests set forth by the Supreme Court will likely affect the characterisation of charges on such intangible assets under Israeli law. This decision takes on additional importance in the current economic climate, which may see more IP-rich companies in insolvency situations or companies that may be looking to use their IP assets to secure financing.

Decision

In *2966/17 SR Accord v State of Israel*, the Supreme Court of Israel set forth three nonexclusive tests that will be used to distinguish between fixed and floating charges under Israeli law. Under the decision, Israeli courts will generally give little weight to how parties to any transaction characterise the lien. Rather, the courts will look to the specific factors enumerated by the Supreme Court:

- the specificity with which the parties characterise the assets subject to the charge;
- the extent to which the lender can control and supervise the use of the charged assets; and
- the character of the charged assets.

Comment

The distinction between a fixed and floating charge can have important consequences under Israeli law, both with regard to the priority of the charge and also with respect to the proportion of receipts from the sale of the charged asset that can be used for repayment of the secured debt.

In applying the second "control" test, the Court generally looked to the actual day-to-day control of the lender over the value and use of charged asset, rather than looking only at the registration of the charge or towards the lender's rights to prevent a wholesale transfer of ownership of the charged asset. While the decision did not directly address charges on IP, the focus of the decision on actual control increases the importance of including such specific control provisions in agreements for charges on IP. Such provisions could include, for example, restrictions on exclusive and non-exclusive licensing transactions without the lender's consent. In addition, such provisions could include restrictions on obtaining certain forms of government grants for funding further development in IP, since, under Israeli law, such government grants may impose significant restrictions on the transfer or licensing of IP. The absence of such control provisions could result in the charge being characterised as a floating charge.

In addition, in applying the third "character" test, the Supreme Court noted that charges on future assets are more likely to be characterised as floating charges. Again, while the decision did not directly address charges on IP, this test may have important consequences for charges on the IP of companies heavily focused on research and development, where important IP may not yet have been reduced to practice at the time that that a fixed charge is imposed.

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