Automatic crystallisation clauses do not necessarily resolve the problems for which they are created.

The validity of a qualifying floating charge created under para 14 of Schedule B1 to the Insolvency Act 1986 does not depend upon whether at the time of its creation the company creating the charge has available assets.

Neither must a company have assets subject to a floating charge in order for the charge to be enforceable.

There appears to be a distinction between (1) property owned by a company at the time of creation of a charge and (2) property acquired by a company with monies secured by a charge created at the date of its acquisition (where the interest in the property belongs to the chargeholder/lender).

Floating charges can overcome the problem of contemporaneous or simultaneous crystallisation of a charge with the event that triggers it by careful drafting.

This article considers the decision of the Court of Appeal in Re Property Edge Lettings Limited [2017] EWCA Civ 1001 and, in particular, whether it is necessary for a company to have assets at the time of the creation of a floating charge for the charge to be valid or assets subsequently, for the charge to be enforceable. It also considers other issues that arise from the decision which remain unanswered, including priority of charges and the timing of crystallisation in certain circumstances.

**AUTOMATIC CRYSTALLISATION CLAUSES: A SHORT HISTORY**

The floating charge came into being about 147 years ago. It was first recognised in the case of *In Re Panama, New Zealand, and Australian Royal Mail Co.* (1870) LR 5 Ch App 318. It usually charges all assets of a debtor company, both present and future, including a company’s circulating assets.

Its advantage is that it gives to the holder of the charge an effective and comprehensive security on the entire undertaking of the debtor company and its assets from time to time, while at the same time permitting the debtor company to trade in the ordinary course of its business without reference to the holder of the charge. This is in contrast to a fixed charge on the whole undertaking and assets, which would paralyse the company and prevent it from carrying on its business.

Under a floating charge, a company is free to dispose of its assets in the ordinary course of its business up until the point when the charge crystallises. Until this point, the charge does not attach to any asset of the debtor company. However, upon its crystallisation, the charge will fix upon the assets charged and will terminate the debtor company’s licence to dispose of, and deal with, those assets.

During the early period of the development of the concept of crystallisation, the court held that a charge would crystallise upon the termination of the business of the debtor company. This occurs if:

- (i) the debtor company goes into liquidation;
- (ii) it ceases to trade or disposes of its undertaking with a view to its ceasing to trade; or
- (iii) the holder of the charge intervenes by, for example, securing the appointment of a receiver.

It soon became clear, however, that attractive though the floating charge might be, its disadvantage was that by permitting the company to continue to trade without reference to the holder of the floating charge, the company was free to dispose of its assets, which included granting specific charges, provided that the dealing was within the ordinary course of its business.

In *Wheatley v Silkstone and Crichton Coal Co.* (1885) 29 Ch D 715 the court held that a floating charge did not prevent the creation of a subsequent specific charge in priority to the floating charge.

This vulnerability to losing priority to later specific chargeholders led to the development of drafting clauses in floating charge instruments, which restricted the debtor company from carrying out certain transactions, including entering into subsequent charges, which might rank in priority to, or pari passu with, the floating charge, without first obtaining the prior express consent of the floating chargeholder.

While the inclusion of such restrictive clauses does provide some protection for the holder of a floating charge, the protection only has limited effect. A subsequent specific charge will still have priority over a prior floating charge if at the time of its execution the holder of the specific charge either did not have notice of the floating charge, or if it did have notice of the charge, it did not have notice of the restrictive provisions in it. In this respect, the courts have held that while registration of a floating charge at Companies House constitutes constructive notice of the existence of the charge to the whole world, it does not constitute notice of the restrictive provision itself, even if particulars of that provision have been registered (*Wilson v Kelland* [210] 2 Ch 306). Presumably, this was because under the registration regime which existed prior to 2013, it was not mandatory to file particulars of restrictive clauses (quaere whether the same conclusion would be reached in respect of charges registered under the current regime where the charge instrument appears on the register).

The limited effectiveness of restrictive provisions led to the creation of automatic crystallisation clauses in floating charge instruments. These prescribe the circumstances in which the floating charge will crystallise. To try and prevent...
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THE FACTS

In December 2007, SAW (SW) 2010 Limited (AW), a shareholder in, and creditor of, Property Edge Lettings Limited (the Company), granted to the Company a long lease of a residential apartment block in Exeter known as Bartholomew House. On 18 December 2007 Capital Homes Loans Limited (CHL) granted a buy-to-let loan of £1.25m to the Company, which was secured by six fixed charges, in substantially the same terms, over each of the flats within Bartholomew House (the CHL Charge). The CHL Charge also contained a fixed charge over the rental income from the flats and a floating charge over the remainder of the Company’s undertaking, property and assets, both present and future. Clause 4.2 of the Mortgage Conditions incorporated within the CHL Charge prohibited the creation of any security interest in the property charged without CHL’s consent. Clause 9.11 provided that if without the prior written consent of CHL, the Company encumbered the property subject to the floating charge then the floating charge would automatically without notice operate and have effect as a fixed charge instantly upon the occurrence of such an event.

Subsequently, on 9 May 2008 the Company provided security to Derbyshire Building Society (DBS) in order to finance the acquisition of development land in Bude, Cornwall (the Development Property).

The security provided included a first fixed charge over the Development Property (the Fixed Charge) and a debenture under which the Company granted DBS a floating charge over its assets (the Debenture). The Debenture made provision for the automatic crystallisation of the floating charge upon certain events and it was common ground that it had crystallised by the time of the appointment of joint administrators.

The security was granted by the Company to DBS without the Company first having obtained the consent of CHL. It was subsequently assigned to the Nationwide Building Society. On 27 January 2012 Nationwide appointed administrators under its Debenture, having first obtained the consent of CHL to the appointment.

On 24 June 2015, nearly 3½ years after the appointment of the administrators, SAW and another creditor, Neil Wilson Accountancy Limited (the Appellants), issued an application challenging the validity of the appointment of the administrators.

The application was struck out by the judge at first instance on the grounds that the particular claim discloses no reasonable cause of action. The Appellants appealed that order to the Court of Appeal.

THE ISSUES WHICH THE COURT OF APPEAL HAD TO DECIDE

The Court of Appeal had to decide three issues:

(i) whether the Debenture created a qualifying floating charge within the meaning of para 14 (para 14) of Schedule B1 (Sch B1) to the Insolvency Act 1986 (IA);

(ii) if so, whether the floating charge created by the Debenture was enforceable on the date of the appointment of the administrators; and

(iii) whether the Debenture was void on the grounds of common mistake.

THE DECISION OF THE COURT OF APPEAL

Under para 14(1) the holder of a qualifying floating charge in respect of a company’s property may appoint an administrator. For the purpose of para 14(1), a floating charge qualifies if created by an instrument which states, inter alia, that para 14 applies to the floating charge or purports to empower the holder of the floating charge to appoint an administrator of the company or purports to empower the holder of the floating charge to make an appointment which would be the appointment of an administrative receiver within the meaning given by s 29(2) of the Insolvency Act 1986. A person is the holder of a qualifying floating charge in respect of the company’s property if he holds one or more debentures of the company secured, inter alia, by a qualifying floating charge which relates to the whole or substantially the whole of the company’s property (para 14(3) of Sch B1). An administrator may not be appointed under para 14 unless the floating charge has become enforceable (para 16 of Sch B1).

The Appellants argued that the appointment of the administrators was invalid, because the Debenture had not created a valid floating charge. Alternatively, the Debenture had not been enforceable at the time that the administrators were appointed. This was because:

- the Company had encumbered the Development Property without having obtained the prior written consent of CHL;
- as a result, upon the grant by the Company of the Fixed Charge, which took place a few hours before the grant of the Debenture, the floating charge under the CHL Charge crystallised and the whole of the Company’s assets and undertaking (to the extent that they were not already subject to a fixed charge) became subject to a fixed charge security in favour of CHL;
- consequently:

- the Debenture could not itself constitute a floating charge, because at the time of its grant,
the Company did not have any property to which such a charge could attach and, for so long as the prior crystallised charge remained outstanding, the directors of the Company had no power to acquire any property for the company thereafter to which the charge could attach in the future;

- alternatively, even if the Debenture created a valid floating charge, it would not become an enforceable floating charge until such time as the company had acquired assets to which it could attach, free from any prior charge, and this had not occurred by the time of the purported appointment of the administrators in 2012.

The Court of Appeal rejected the Appellants’ arguments. It examined the provisions of Sch B1 set out above and also the authorities which deal with the nature of floating charges, in particular, Re Yorkshire Woolcombers Association Limited [1903] 2 Ch 284, 295 and Re Spectrum Plus Limited [2005] 2 AC 680, paras 99, 106–7, 111 and 139. It held that, having regard to those authorities and to the provisions of Sch B1 as amplified by IA s 251, the validity of a floating charge did not depend upon whether at the time of its creation the company creating the charge had uncharged assets, free from any fixed charge arising from the crystallisation of a prior floating charge. For the purpose of para 14, the question of whether any charge was a floating charge had to be answered as at the date of its creation and this would be determined only by reference to the construction of the relevant instrument creating the charge, not by whether there were assets to which the charge might attach. This conclusion had been reached in the case of Re Croftbell Limited [1990] BCC 781, relating to the predecessor provision of IA s 29(2), which Lord Justice Briggs (as he then was) held was not different in any relevant respect from para 14.

In support of his decision as set out above, Lord Justice Briggs also referred to two points made by Mr Justice Vinelott in Re Croftbell Limited in his analysis of s 29(2). They were: first, that very often a company will grant a floating charge for the purpose of setting itself up in business by borrowing working capital before it has any or any significant assets to which the charge can attach; and, second, that, even where there is a prior fixed charge on assets, a floating charge will still attach to the company’s equity of redemption in those assets. Accordingly, the Court of Appeal held, as a matter of construction, that the Debenture had created a valid floating charge, despite the simultaneous crystallisation of the floating charge in the CHL Charge.

The Court of Appeal also rejected the Appellants’ alternative argument that the floating charge was unenforceable at the time of the appointment of the administrators, because there were no assets to which the charge could attach. Lord Justice Briggs gave four reasons for rejecting this argument, one of which was that whether or not a charge is enforceable will depend upon whether the chargee has the right to enforce it, rather than whether there are free assets to which the chargee can have recourse for the purposes of enforcement. He said that a floating charge can be enforced if any condition precedent to enforcement has been satisfied (such as an event of default) and there remains a debt for which the floating charge stands as security.

Finally, the Appellants argued a case based on common mistake, but this played little part in the appeal and was dismissed in a few lines.

UNDECIDED ISSUES

The Court of Appeal’s decision is useful as it clarifies the approach to be taken in determining whether a charge is a qualifying floating charge for the purpose of para 14 and whether it is enforceable for the purpose of para 16. However, it raises, but does not answer, other interesting questions. They are:

- whether, in that case, the CHL charge had crystallised; and
- the timing of crystallisation and its importance.

CRYSTALLISATION OF CHL CHARGE

At first instance, His Honour Judge Hodge QC decided the case in favour of the respondents on different grounds. He held that the floating charge under the CHL Charge did not crystallise upon the grant by the Company of the Fixed Charge. There were, therefore, assets available to which the floating charge under the Debenture could attach. The judge did not, however, consider (and it does not appear to have been argued) whether the grant of the Debenture crystallised the floating charge in the CHL Charge and, if it had, whether he would have reached a different conclusion.

While the judge held that this was a complete answer, Lord Justice Briggs disagreed, although he did not say that the reasoning of the judge was wrong. While the approach of the Court of Appeal to the issues raised before it was clearly the right one, the decision of the court below raised interesting questions both in relation to whether the automatic crystallisation clause had, indeed, been triggered and, if it had been, whether the CHL Charge or the Fixed Charge had priority in respect of the Development Property.

There is no doubt that the restrictive clause in the CHL Charge and the automatic crystallisation clause covered the creation of charges over future property. However, is a distinction to be made between property owned by a company at the time of creation of a charge and property acquired with monies secured by a charge created at the date of its acquisition? It would appear that there may well be. In the case of Abbey National v Caan [1991] 1 AC 56, it was established that when a specific charge is granted over a property as security for monies advanced for the purpose of its acquisition, the acquisition of the legal estate in the property and the granting of the charge over it are to be regarded as one indivisible transaction. As a consequence, the purchaser never acquires anything other than the equity of...
Some practical points in relation to the crystallisation of floating charges seek to crystallise may affect whether it has had crystallised. The moment when a floating charge encumbrancer until the floating charge would be subject to the prior charge. In this situation, the subsequent chargeholder had notice of the restrictive provision in the relevant restrictive clause in the CHL Charge. In cases where equitable interests are created after the grant of a floating charge, it is, therefore, important to determine whether the floating charge has crystallised and, if so, when it crystallised.

Where, as in the case of Re Property Edge Letting Limited, the charge provides that if the company encumbers its property without the prior consent of the chargee, the floating charge will automatically operate and have effect as a fixed charge instantly such event occurs, the question arises as to whether, if a subsequent equitable charge is created, the crystallising event is simultaneous with the grant of the subsequent charge with the result that it has priority over that charge or, at the very least, ranks pari passu with that charge or crystallises immediately after completion of the charge. Although this was not an issue that needed to be decided in Re Property Edge Lettings Limited, there was a divergence of opinion between the two judges. Briggs LJ held the view that the Australian decision of Fire Nymph Products Ltd v Heating Centre Pty Ltd (in liquidation) (1992) 7 ACSR 365 would be followed in this jurisdiction. That case, which had a similar crystallisation clause to that in Re Property Edge Letting Limited, decided that crystallisation would take effect simultaneously with the relevant event, a decision that appears to have been adopted by Chadwick J in the case of Re Real Meat Co. Ltd (1986) BCC 254 (although that case was not concerned with crystallisation under an express crystallisation clause). Arden LJ, however, did not take the same view. She held that, as a matter of construction, the phrase ‘instantly such an event occurs’ could mean either “simultaneous (in the same moment)” or “forthwith” or “immediately upon” the occurrence of such an event. She herself preferred the latter interpretation and was of the opinion that crystallisation of the CHL Charge had occurred after, and not at the same time as, the creation of the Debenture (and implicitly the Fixed Charge). If this interpretation is correct, had an equitable charge over property of the Company been created instead of the Fixed Charge, this charge would have had priority over the earlier floating charge created by the CHL Charge.

Whatever the correct interpretation of the clause in Re Property Edge Letting Limited, many floating charges seek to overcome the problem of contemporaneous or simultaneous crystallisation of a charge with the event that triggers it by providing that the floating charge will crystallise immediately in the event that the chargor subsequently attempts to create a prior or equal ranking encumbrance. Such clauses have been upheld in the Commonwealth courts (see, for example, the New Zealand case of Re Manurewa Transport Ltd [1971] NZLR 909 (the attempt being when the charger puts pen to paper to execute the charge), which was approved in the Fire Nymph Products case). The advantage of such clauses, assuming that the English courts adopt a similar approach, is that the floating charge will crystallise before the creation of the subsequent charge and, therefore, have priority over any subsequent interest.

**Further Reading:**
- Some practical points in relation to the granting of floating charges (2016) 6 JIBFL 366.
- LexisNexis Loan Ranger blog: Floating charges for building societies.