

creditors. In 1986, the Insolvency Act reversed *Re Brightlife* by applying the section to any charge ‘created as a floating charge’, regardless of subsequent crystallisation. In Hong Kong the former rule still applies so that ‘once a floating charge always a floating charge’ for the purposes of section 265 of the former Companies Ordinance (Cap 32).

5. FIXED AND FLOATING CHARGES

[8-37] A charge is always equitable unless it is ‘a legal mortgage by way of legal charge by deed’: section 44(1) of the Conveyancing and Property Ordinance (Cap 219). So, a common, commercial charge, over the benefit of a chose in action or of a chose in possession, is referred to as a ‘creature of equity’ for which the three essentials are:

- (a) intention to provide security for the creditor;
- (b) adequate identification of the asset subject to the charge; and
- (c) the asset charged is either a chose in action or a chose in possession.

This charge requires some ‘proprietary’ elements making the asset capable of being dealt with by encumbering the interest or assigning the interest pending repayment: see for example *Hong Kong and Shanghai Banking Corporation v Star Trans International Ltd* [1988] 2 HKLR 549, [1988] HKCU 416 (CA), where it was said of a textile export quota right that:

In summary to be registered as the holder of an appropriate quota is a prerequisite to obtaining an export licence; it confers an expectation that, in the ordinary course, a corresponding licence will be granted though not an enforceable legal right ... Their lordships have no hesitation in concluding that export quotas in Hong Kong although not ‘things in action’ are a form of ‘other intangible property’.³⁵

[8-38] A charge over company property can be fixed or floating, although it is more usual to use a floating charge.³⁶ A floating charge is an:

equitable charge on the assets for the time being of a going concern. It is the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created intervenes.³⁷

It applies to present or future property, and enables the company to deal with the property in the ordinary course of its business prior to crystallisation. Conceptually:

It 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 applied to every item comprised in the security, but not specifically affecting any until some event occurs...³⁸

35 Referring to *A-G of Hong Kong v Chan Nai-Keung* [1987] 1 WLR 1339, [1987] HKLR 70 (PC) in considering section 5(1) of the Theft Ordinance (Cap 210).

36 *Re Yorkshire Woolcombers’ Association* [1903] 2 Ch 284 (CA, Eng).

37 *Government Stock & Co Ltd v Manila Railway Co* [1897] AC 81 at 86.

38 *Evans v Rival Granite Quarries* [1910] 2 KB 979 (CA, Eng).

The power to deal with the property free of the security pending crystallisation derives from the contract. When the benefit of a chose in action is charged it is essential for the debtor (that is, the party to be sued on breach of the contract creating the book debts) to be notified; even if only to inform him where to pay.³⁹ An equitable assignment such as this does not require, for perfection, that the debtor be informed. Whatever the interest is, it must be one giving the chargee the right to fulfil the chargor's obligations, now in default.⁴⁰ The House of Lords in *Re BCCI (No 8)* [1997] 4 All ER 568, [1998] AC 214 observed that a fixed charge gives the chargee contingent rights, that is, proprietary rights. For equitable relief, consideration must be present for 'equity will not assist a volunteer'; even the presence of a deed (without the presence of consideration) does not counteract this maxim. How then would equity react to a charge, without consideration? Obviously, equity does protect the beneficiary under a trust where that beneficiary does not provide consideration, because the conscience of the trustee is bound to honour the intention of the grantor of the trust. With a charge covering future property, it is said that the chargor is bound, as trustee, as soon as the property comes into his hands, and prior to then is subject to the maxim that 'equity looks on that as done that which ought to be done' thereby binding the chargor from entry into the contract. Therein lies the answer. The charge will not be entered into other than as a commercial transaction (even if the borrower is an individual); there is no gift to the chargor, and hence there is no possibility of the absence of consideration; hence equitable relief will flow from the breach.

[8-39] Generally, a document, often referred to as a debenture,⁴¹ will provide for both fixed and floating charges, as well as referring to other forms of security or quasi-security.⁴² Commonly, the debenture is a form of a loan agreement issued by a company in which it: (a) acknowledges a debt, (b) promises to repay, and (c) contains a charging clause promising to effect various forms of security, including quasi-securities. In Hong Kong, a common form is that of a debenture to create a 'building mortgage' requiring approval under the Consent Scheme administered by the Lands Department (which enables the first purchaser of the Government lease to construct a building on the land) in support of a construction contract, will often contain a fixed charge over the property, a floating charge over all the undertaking, property and assets of the developer, an assignment of the insurances effected over the property, and a charge or assignment over all monies payable from the stakeholder.

5.1 The floating charge

[8-40] The decision in *Holroyd v Marshall* (1862) 10 HL Cas 191, [1861–1873] All ER Rep 414 marked the end of the ancient dispute between common law courts and equity over bills of sale. The result was that common law maintained its position that there could be no dealing with future property, but equity maintained

39 *Armour & Anor v Thyssen Edelstahl-Werke AG* [1990] 3 WLR 810 (HL).

40 See *Linden Gardens Trust Ltd v Lenestra Sludge Disposals Ltd* [1994] 1 AC 85 (HL).

41 See ss 307 to 332 of the Companies Ordinance (Cap 622).

42 *Knightsbridge Estates Trust Ltd v Byrne* [1939] Ch 441.

its position that such dealings were appropriate. The agreement between the parties concerned a security which was valid in equity, and for which no further documentation, or act of transfer, or other document or action was necessary to create the security. There are two matters of concern, namely (i) creation of the interest, and (ii) perfection for protection against third parties. Once the security had been *created* without external intervention, the question of perfection to ensure protection of the chargee against third parties became a separate matter. Some separate act of *perfection* – such as registration, taking possession of the asset, or giving notice to relevant parties in control of the asset – will be required. This act of perfection then ensures that not only the right to enforce the lender's interest against third parties generally, but it also elevates the perfected security into an asset able to withstand or stand against the bankruptcy or insolvency of the debtor.

[8-41] The secured interest as a floating charge is fragile in securing full protection for the chargee. Its priority can be defeated by a subsequent fixed charge. To seek protection against this, commonly the chargee will seek to ensure that actual notice of a negative pledge (or similar provision) is given to third parties to enhance the chargee's rights as first in time; even to the extent of an action in tort against a third party inducing the chargor to breach the contract.⁴³ The charge rests on no particular asset until crystallisation but as a present security; crystallisation can result without the need for any new demonstration against specific assets. It is to be noted that the consequence of the floating charges as a present security enables the chargee, on that crystallisation, to pursue assets disposed of by the chargor before crystallisation when that disposal was *not* in the ordinary course of business.

[8-42] The chargee will also require the charge to be converted into a security over assets of the chargor able to withstand the bankruptcy or insolvency of the debtor through crystallisation. This conversion is not able to withstand the terms of preferential creditors under section 266 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32).

[8-43] The floating charge is a 'dormant' interest attached to subject matter which can change from time to time until some future step is taken, such as crystallisation. The floating charge operates to allow a *defined value*, measured against assets, to take effect over a range of property, but over none specifically until (and unless) it crystallises; at that time, the charge attaches to specific property.⁴⁴ It is 'dormant' although technically 'attached' to all assets of the chargor, even though that subject matter changes from time to time, and although it is really attached to no specific asset until some future action or step is taken, or event occurs. The subject matter changes from time to time because the equitable charger has a right to deal with the assets in the ordinary course of his business until crystallisation. It is for this reason that it became essential from the nineteenth century to create further charges, including fixed charges. For this reason the effective negative pledge was essential.

43 *OBG v Allan* [2008] 1 AC 1 (HL).

44 *Re Yorkshire Woolcombers Association* (on appeal to the House of Lords as *Illingsworth v Houldsworth* [1904] AC 355).

The creation of the floating charge by equity did not, and still does not, mean that the chargee has priority over the assets secured. For example, the floating chargee is subjected to section 265(3B) of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap 32, and a subsequent fixed charge will take priority (except in the case of actual fraud by the chargee). Until it becomes fixed, the chargor has a right to deal, in the ordinary course of its business, with the assets, for example, to collect the proceeds of the book debts; so, when an floating charge is created in favour of a bank. In *Royal Trust Bank v National Westminster Bank plc* [1996] 2 BCLC 682, Millett LJ in the Court of Appeal said at 705 that the chargor:

[N]otwithstanding the fact that its right do so had been assigned in equity to the bank, the company's right (and duty) to collect the receivables is not therefore a matter of acquiescence by the bank, it is contractual.

[8-44] The proper characterisation of a security as 'fixed' or 'floating' depends on the freedom of the chargor to deal with the proceeds of the charged assets in the ordinary course of business free from the security; in other words 'who has control of the asset?'. The chargor has a contractual right against its debtor to collect the proceeds and pay them into its own bank account for use in the ordinary course of its business; this is a badge of a floating charge and is inconsistent with the existence of a fixed charge.⁴⁵ This contractual right continues until crystallisation or reliance on other means of converting the floating charge into a fixed charge. Until then, unless the contract provides otherwise, money collected belongs to the chargor.⁴⁶ The floating charge has become a sophisticated form of security which can be used in respect of land (*albeit* as a *legal* charge) as well as personalty. It is dormant until the company defaults and the mortgagee takes steps to realise the security, or the company is wound up.⁴⁷ The crystallising event then attaches the charge to specific securities by creation of a fixed charge thereupon with priority being given over unsecured creditors of those assets.

The use of the floating charge points to its versatility. It is possible to have a floating charge over land, but it is to be discouraged because section 56A of the Conveyancing and Property Ordinance does not apply until crystallisation, nor does section 2A of the LRO. Thus, any protection those Ordinances might have given is unavailable until crystallisation, and by then it may be too late to give the chargee any priority. The most common asset subjected to the floating charge is that of 'receivables' or 'book debts'. As they have duality of classification: (i) as a chose in action and thus present property but without real 'value' at that point of time, other than as an action to sue, and (ii) as future property with real 'value', namely the proceeds of the chose in action which must be 'secured' effectively to protect the lender.

45 See *Re Brightlife Ltd* [1986] BCLC 418, at 422.

46 *Re Yorkshire Woolcombers Association Ltd* (on appeal to the House of Lords as *Illingworth v Houldsworth* [1904] AC 355).

47 *Government Stock & Co Ltd v Manila Railway Co* [1897] AC 81.