

Floating Charges

by Aric Wong Fong Chin

A floating charge is a security given by a company to a chargee to secure payment obligations. It is usually incorporated in a debenture.

A floating charge is commonly created over a range of tangible and intangible assets such as stock in trade, raw materials, goods in manufacture, cash in hand, book debts and shares. Normally, the charge would cover the entire business of the company. By its nature, the floating charge will include future assets that do not exist at the time the charge is created.¹

A floating charge operates in equity, and becomes a fixed charge upon a “crystallisation event” which is usually defined in the debenture, such as:

- (1) A default in the company’s payment obligations;
- (2) Company going into liquidation;
- (3) Any action of the company that jeopardises the charged assets.

Crystallisation

The debenture usually defines a set of events, with the stipulation that upon occurrence of any of the events, the charge will crystallise into a fixed charge and the chargee will have the option to enforce the charge. One crystallisation prominently stipulated is when the company

seeks to create a charge or some form of security over an asset that is subject to a floating charge.

Until crystallisation, the interest conveyed under a debenture to the chargee is somewhat similar to a beneficiary under a trust fund. As long as the trust fund is properly managed, the beneficiary does not have a right to any specific asset under the trust until the trust is terminated or a crystallisation event in the case of a debenture.²

Enforcement

The nature of the floating charge is that the company may continue to use the charged assets in the ordinary course of its business until there is a crystallisation,³ whereupon crystallisation, the company’s power to deal with its assets ceases, and the chargee is entitled to appoint a receiver and manager over the assets subject to the charge. In most cases, this also means that the receiver and manager will take over the entire business and undertaking of the company.

Subsequent charges

The company is usually prohibited from creating any subsequent charge over any asset in favour of any other party without the consent of the prior chargee. However, companies with the aim of raising funds are known not to comply with such a prohibition in the floating charge.

The question then arises: In what circumstances will a subsequent chargee gain priority over the floating charge? This question can be answered by addressing the following issues in the order appended below.

1 *In Re Panama* (1870) 5 Ch App 318 (CA), it was held that (at 322-323):

“... the word “undertaking” had reference to all the property of the company, not only which existed at the date of the debenture, but which might afterwards become the property of the company... I hold that under these debentures they have a charge upon all property of the company, past and future, by the term “undertaking,” and that they stand in a position superior to that of the general creditors, who can touch nothing until they are paid.”

2 Professor R M Goode, *Legal Problems of Credit and Security* (Sweet & Maxwell, 12th Ed, 1988)

3 *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 919

(1) Registration

The company is required to register the charge within 30 days of its creation.⁴ If this is not done, the charge would be void against the liquidator and any creditors of the company.⁵ If this happens, the charge will not secure the priority of the chargee and the chargee will effectively be relegated to the position of an unsecured creditor.

To avoid possible non-registration by the company, any person interested in the charge may register the charge before the end of the period allowed for registration.⁶

Registration is essential for the chargee to establish any form of priority over the asset of the company.

(2) Restriction

Because a chargee's interest in a floating charge does not attach until crystallisation, it is commonly stipulated in the debenture that the company is not to create any charge or security over any asset that is subject to the floating charge.

Common prohibitions include parting with possessions, transferring, selling, leasing or otherwise disposing of the assets charged except in the ordinary course of business.

A subsequent chargee who has notice of the floating charge and of the restriction against dealings with the assets under the floating charge will not gain priority.⁷

(3) Notice

The registration of the charge does not require that a copy of the debenture be lodged. It only requires that a prescribed form containing the particulars be lodged.⁸ It is therefore prudent for a chargee to provide not only the particulars of the assets subject to the charge but also the restriction against the dealings with the assets and creation of subsequent charges.

It has been held that documents lodged with the Companies Commission are deemed public documents, and parties who deal with the company are deemed to have constructive notice of its contents and put on inquiry of the same where necessary.⁹

If the full details of the prior chargee's charge, in particular the restriction, appear in the documents filed with the Companies Commission, it would be inequitable for a subsequent chargee to argue that it had gained priority without notice of the prior chargee's interest.¹⁰

(4) Consent/Waiver

It is not uncommon for the chargee to agree to waive its interest in favour of a subsequent chargee for specific assets. The advantage to the chargee for giving such a waiver would be in allowing the company to strengthen its financial condition by accessing other funds, thereby indirectly protecting the interest of the chargee.

A waiver by the prior chargee cannot be withdrawn as the subsequent chargee would have acted in reliance of it.

4 Companies Act 2016, s 355

5 *Ibid*, s 352(2)

6 *Ibid*, s 352(8)

7 *Kay Hian & Co (Pte) v Jon Phua Ooi Yong & Ors* [1989] 1 MLJ 284 (SGHC) at 287

8 The form currently in use is similar to Form 34, Companies Act 1965

9 *KL Engineering Sdn Bhd & Anor v Arab Malaysia Finance Bhd* [1994] 2 CLJ 480 (SC)

10 *Wilson v Kelland* [1910] 2 Ch 306; *Kay Hian & Co (Pte) v Jon Phua Ooi Yong* [1989] 1 MLJ 284, at 287

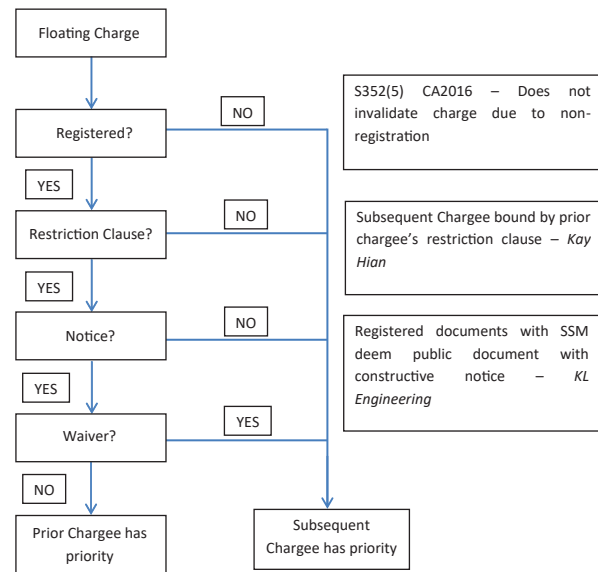
Conclusion

In essence, the foregoing paragraphs provide a logical order of issues to determine priority. The chargee's interest is best protected by ensuring that the debenture:

- (i) defines clearly the assets subject to the charge;
- (ii) prohibits in clear terms the creation of further security over the assets without consent;
- (iii) the charge be registered at the earliest time possible within the prescribed time limit;
- (iv) the form to be lodged with the Companies Commission contains full particulars not only of the assets but also of the restrictions in dealings and creation of further security without consent;
- (v) no waiver ought to be given without full knowledge and understanding the consequence of the waiver.

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The following flow chart offers a simple overview of the factors to be taken into account in deciding when a subsequent charge can gain priority over the floating charge:



About the author



Aric Wong Fong Chin (wfc@lh-ag.com) is a senior associate with the Banking & Insolvency Practice, and is part of a team led by **Sean Yeow Huang-Meng** (yhm@lh-ag.com)