

The Automatic Crystallisation Clause in a Floating Charge

by Ong Eu Jin and Eileen Tan Yuh Wen

As a matter of law, a floating charge crystallises upon the occurrence of the following events:¹

- (1) cessation of business, including winding up and ceasing business operations as a going concern prior to winding up; and
- (2) debenture holder intervention, including appointment of a receiver or manager, taking possession as debenture holder and obtaining an injunction against company dealings with charged asset generally.

Until crystallisation, the company is free to manage and deal with the charged assets comprising the security in the ordinary course of business.

“Automatic crystallisation”, otherwise known as “express crystallisation”, refers to events that are explicitly agreed between the parties to the floating charge to trigger crystallisation without requiring the debenture holder to do any act.

Upon the occurrence of such an event, the floating charge then crystallises and the security interest of the debenture holder is said to attach to the charged assets and the charge becomes a fixed charge.²

Such events upon which the floating charge is to crystallise are purely a matter of contract and parties are free to make their own agreement.³

Some express crystallisation events that the courts have held to be valid include the following:⁴

- (1) appointment of a receiver and manager under a prior ranking fixed and floating charge;
- (2) charging or attempting to charge its assets by a chargor contrary to the provisions of a restrictive covenant against creating any prior or equal ranking charge;
- (3) the giving of a notice to the company converting the floating charge into a specific charge in relation to the charged assets specified in the notice;
- (4) any defined event of default, for example, the making of a demand by the debenture holder for all money due;
- (5) dealing with the charged property contrary to an express restrictive covenant against dealing with the charged property other than in the ordinary course of its ordinary business.

Clauses that merely empower a debenture holder to intervene are not sufficient to crystallise a floating charge in the absence of actual intervention.⁵

1 William James Gough, *Company Charges* (Butterworths, 2nd Ed, 1996) at p 232

2 As per Buckley LJ in *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979:

“A floating charge is not a future security; it is a present security which presently affects all the assets of the company expressed to be included in it... A floating security 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 applying to every item comprised in the security, but not specifically affecting any item until some act or event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security”.

3 *Fire Nymph Products Ltd v Heating Centre Pty Ltd (in liquidation)* (1992) 7 ACSR 365 at 378:

“Since crystallisation is a matter of contract the question whether property dealt with otherwise than in the ordinary course of the company's ordinary business will, on crystallisation, be subject to a fixed charge may be treated as a matter of drafting technique.”

4 Gough, *supra* n 1, at p 233-234

5 Roy Goode, *Goode on Legal Problems of Credit and Security* (Louise Gullifer ed) (Sweet & Maxwell, 4th Ed, 2008) at p 165

It has been said that the debenture holder's act of intervention must satisfy a threefold test;⁶

- (1) it must be done with the intention of converting a charge into a fixed charge;
- (2) it must be authorised by the express or implied terms of the debenture; and
- (3) it must divest the company of *de jure* control of the assets.

Clear intention

Clear language is necessary in a floating charge contract to create an effective express crystallisation clause:

"... provided the language of the debenture was sufficiently clear, there was no conceptual reason why the parties should not agree that any specified event should cause the charge to crystallise".⁷

Overkill

Many debenture holders and their legal advisers are in the habit of setting out lengthy covenants in a debenture as safeguards for fear of losing its priority over the charged asset to subsequent charges. Such a drafting practice can be unhelpful. It may lead the court to conclude that the whole clause should be ignored as not truly reflecting the intention of the parties.⁸

Understandably, the courts would interpret automatic clauses very strictly and if the drafting is unclear and crystallisation in circumstances other than the implicit

crystallisation events would 'paralyse' the business as a going concern, the parties may be presumed to not have intended the express crystallisation:⁹

"... the commercial inconvenience of automatic crystallisation gives rise to a strong presumption that it was not intended by the parties. Very clear language will be required."

Accordingly, automatic crystallisation clauses should be restricted to events that are of such significance that, if it occurs, the creditor will almost inevitably want the company's power of management to end. Other less significant events should just entitle the debenture holder to intervene.¹⁰

'De-crystallisation' or 'Re-floatation'

Such overprotective covenants can endanger the security of the debenture holder. Very often, it is quite easy for the company to commit a breach of a technical nature without either the debenture holder or the company being aware. Upon discovering such an event, a debenture holder would then reverse the crystallisation or ignore the breach, in which case the charge is said to have "de-crystallised".

A situation in which "de-crystallisation" may occur is where the automatic crystallisation is triggered by a relatively minor breach by the company and the debenture holder allows the debtor to continue with its dealing with the charged assets in the ordinary course of business, thereby waiving the crystallisation of the charge. In such a case, the charge is said to "re-float".¹¹ The effect of this is unclear.

6 *Ibid* at p 158

7 Hoffman J in *Re Permanent Houses (Holdings) Ltd* [1988] BCLC 563, reaffirming his previous statement in *Re Brightlife Ltd* [1987] Ch 200 at 213

8 Goode, *supra* n 5 at p 166

9 *Re Brightlife*, *supra* n 7:

"In my view however, the speeches in the Manila Railway case make it clear that the House of Lords regarded the question as being on of construction alone. They give rise to a plain inference that a sufficiently explicit provision for automatic crystallisation on default would have been given effect. It is true that the commercial inconvenience of automatic crystallisation gives rise to a strong presumption that it was not intended by the parties. Very clear language will be required. But that does not mean that it is excluded by a rule."

10 Goode, *supra* n 5 at p 167

11 *Ibid* at p 168

On one view, no new charge is created and so no fresh registration is required under the Companies Act 2016 since the de-crystallised charge is exactly the same charge as the crystallised charge, on the basis that the incidents of the charge are for the parties to determine, and that the nature of the charge is a matter of contract.¹² On the other hand, de-crystallisation necessarily requires the release of the crystallised charge and the creation of a new floating charge and therefore this new charge will require a new set of registration formalities.

Partial crystallisation

To avoid the hazard of overprotective covenants, it has been suggested that the charge can provide for the crystallisation to take effect over specific asset, if found by the debenture holder to be in jeopardy, but to continue to “float” over the other assets of the company.¹³

An example of a clause that gives the debenture holder the right to convert the floating charge into a specific charge as regards any assets specified in the crystallisation notice¹⁴ that has been given effect to by the courts is as follows:

“[The debenture holder] may at any time by notice to [the Company] convert the floating charge into a specific charge as regards any assets specified in the notice which [the debenture holder] shall consider to be in danger of being seized or sold under any form of distress or execution levied or threatened or to be otherwise in jeopardy and may appoint a receiver thereof”.¹⁵

Drafting considerations

For an automatic crystallisation clause to be effective, the language in the charge document must clearly specify that the floating charge is to crystallise immediately and without

any intervention by the debenture holder as a result of the occurrence of the automatic crystallisation events.

The automatic crystallisation events in the charge document should only be confined to significant events which, upon the occurrence of which, the debenture holder will almost inevitably want the company’s power of management to end, for example, upon the enforcement or the creation, or the attempted creation of a charge.

All other events should be subject to intervention by the debenture holder.

The use of partial crystallisation provision shall be explored as an alternative of automatic crystallisation of the charge over the entire body of assets.

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¹² *Ibid* at p 169

¹³ Gough, *supra* n 1 at p 257 on selected express crystallisation events

¹⁴ *Ibid* at p 236: “Crystallisation notice” is a term used by Gough to describe a notice by the debenture holder to the company to convert the floating charge into a fixed charge

¹⁵ *Re Brightlife*, *supra* n 7