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FLOATING CHARGES, CRYSTALLISATION AND AFTER-ACQUIRED PROPERTY

by

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FLOATING CHARGES, CRYSTALLISATION AND AFTER-ACQUIRED PROPERTY

By G.C. THORPE *

From the outset it must be said that there is already sufficient written by judges, academics and text writers to state that the issues to be canvassed under this topic are, without further judicial comment, not possible of absolute resolution. However, for the assistance of all this paper is perhaps best described as firstly, a quick tiptoeing through the many learned (and not so learned) articles and comments in the area; and secondly, consequential analysis of automatic crystallisation on after-acquired property. Perhaps it would be helpful at this stage to state that the author's objective is not to determine whether automatic crystallisation clauses are valid or otherwise, but moreover to point out the danger that may arise in respect of after-acquired property if automatic crystallisation clauses are found to be as effective as Speight J. held in the case of In re Manurewa.[1] It is a further objective of the author that the discussion of the concepts involved in this area of the law will assist us all, practitioners, academics and students to a better understanding of these issues.

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1. [1971]N.Z.L.R. 909.

1. THE NATURE OF THE FLOATING CHARGE

For the purposes of this paper, the important analysis of the nature of the floating charge relates not so much to the effect of the charge on the assets of the company during the period in which the charge is floating, but more, to the effect of the charge on those assets after crystallisation:- that is, when the charge becomes fixed. In the final part of this paper the question of the effect of the fixed, crystallised debenture on after-acquired property will be analysed.

Farrar[2] argues that the interest of the debenture holder in the assets while the charge is floating is a defeasible equitable interest. Some effort is made in that article to distinguish the view of Gough[2A] who maintains that such debentures create only mere equities which do not vest or become fixed until crystallisation, at which time they vest and become a complete equitable interest. Farrar refers to some early English decisions[3] as authority for his proposition that the floating charge gives something more than a mere equity or a bundle of equities. It gives rise to an interest which in some circumstances at least amounts to an equitable interest in the property. The cases referred to could be seen to be supported by the recent decision of the Supreme Court of Western Australia in Landall Holdings Limited and Others v. Caratti and Others[4] where a parent company executed a debenture trust deed creating a floating charge. A number of the subsidiaries of that company including Landall Construction and Development Company Pty. Limited gave a group guarantee and charged their undertakings. Subsequently, Landall Holdings Limited executed a

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2. Prof.J.Farrar, "World Economic Stagnation puts the Floating Charge on Trial" (1980) 1 Company Lawyer 83.

2A. Dr.W.J. Gough, "Company Charges", Butterworths.

3. Driver v. Broad [1893] 1 Q.B.744; Wallace v. Evershed [1899] 1 Ch.891; and In re Dawson [19]5] 1 Ch.626. Prof.Farrar appears to discount the view of Dr.Gough in his work 'Company Charges' for not discussing one or two of the earlier cases. Perhaps Prof.Farrar may care to read Biggerstaff v. Rowatt's Wharf Co. [1896] 2 Ch.93 where the Court of Appeal per Lindley L.J. at 191..."carry on its business as if the debentures did not exist".

4. [1979] W.A.R.97.

deed of compromise with the respondent whereby certain disputes between the parties were resolved. Under this deed, Landall Construction Limited agreed to transfer some land to the respondent. At the time Landall Construction and Development Company Pty. Ltd. ("L.C.D.C.") was the registered owner of the land. A transfer was executed by L.C.D.C. but not registered. Subsequently a Receiver was appointed over the Landall Group. The transferee sought a declaration that it had been the beneficial owner of the land since the date of transfer and that the transferor was a trustee of the legal estate and thereby sought an account of the sale proceeds. The majority of the Full Court held that the debenture trust deed gave the debenture holders an immediate equitable interest in the assets charged but that while the charge continued to float, that interest could be extinguished by alienation of the subject matter. More particularly, Lavan S.P.J. adopted the view that the floating charge was a species of hypothecation as distinct from a mere equity, and distinguished between the chargee's rights which are only exerciseable on default and his interest in the res which exists prior to default. Wickham J. recognised the existence and equity of an interest, supportable by an equitable right in property not yet in existence or not yet acquired, which interest sprang up on production or acquisition of the thing.[5] Furthermore, this equitable right which sprang up upon acquisition was also a "floating right" in that it springs up when the property comes within the ambit of the charge, and it floats away when an equitable interest in another is conferred by the chargor, and this is so even although the thing itself may remain in the possession of the chargor and even although the legal proprietary interest in the thing may remain in the chargor[6]:

> "If a third party acquires the equity in the asset before the chargee gathers in his equity, then when the chargee comes to gather it in he finds it is gone - in the language of the metaphor it has floated away - or if it is a matter of priorities, it has submerged".

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5. Reference is made to Holroyd v. Marshall (1862) 10 H.L.Cas 191. Generally as to developments from this notion see The Genesis of the Floating Charge; Pennington 23 M.L.R. 630.

6. Per Wickham J. ibid.,108-109.

Wallace J., who dissented, adopted the view that execution of the debenture created only a mere equity which did not vest or become fixed until crystallisation when it vested and became a complete equitable interest. However, such a view of the nature of the floating charge does not affect the overall result in regard to the rights of the third party. Accordingly, notwithstanding the divergence as to the nature of the charge while it floats, the whole court held that had there been a transfer of the land, it would have extinguished the equitable interest (such as it was) of the debenture holder in the land. The majority held that the documents evidenced a transfer and therefore the beneficial interest vested in the transferee, and the receiver was held to account.

With great respect it is suggested that whether the interest created under a floating charge is a mere equity which does not vest until the charge becomes fixed or whether it is defeasible, equitable interest as argued by Farrar may well be one of those areas of academic significance / but practically rather barren. In support of this contention, reference is made to Landall Holdings where as already said, irrespective of which view was taken viz. a mere equity or an equitable interest (defeasible) the practical result as related to the interests of the third party was the same.

The writer prefers to analyse the nature of the floating charge from the standpoint of its creation of non-defeasible equitable proprietary interests in the asset charged. Although the concept of the 'bundle of rights' approach to the questions of proprietary interests has been with us for some time[7], its discussion in text books or cases is rather limited.[8] The basis of this explanatory theory is that the right of ownership of property is the general, permanent, and inheritable right to the uses of that property, notwithstanding that for some temporary period this right of ownership may be subject to specific rights or encumbrances vested in other persons. The concept of 'a

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7. See "Salmond On Jurisprudence" 11th Ed., Glenville Williams.
8. But see Leys & Northey, Commercial Law in New Zealand, 7th Ed.

proprietary interest' involves a certain relationship between a person and the property by virtue of which the person has certain rights which he may exercise over the property. Such rights may be spoken of as in the re, that is, exerciseable in, to and over the thing or property. It is the aggregation of all these proprietary rights, or if you like, the total bundle of proprietary rights which is referred to as ownership or dominium. Thus, where a person has ownership of a res he has the total bundle, or the aggregation of rights in re such as the rights of possession and enjoyment, the rights of transfer and disposal. The owner may divest himself of certain of these rights whether by way of gift, hire or to secure his indebtedness to a creditor. Nevertheless, he will remain the owner of the goods notwithstanding the encumbrances, provided he retains the residual proprietary right in the goods that is, the proprietary rights that remain upon the extinguishment of the encumbrance. Of course, all these proprietary interests by way of security, as they do not involve the transfer of full legal title, will be mere equitable proprietary interests. In this position such interests will be subject to the rights of a bona fide purchaser of the legal estate for value without notice of the earlier equity. But as against all other equitable interests, the indefeasible equitable proprietary interest of the debenture holder when acquired will rank in priority in order of time of creation. It is therefore submitted that the question of relevance is not as to the nature of the equity prior to it becoming an indefeasible proprietary interest, but when such an equitable proprietary interest is created under a floating charge debenture. In a somewhat novel approach to this problem, it is suggested that the most useful analysis of the nature of the floating charge which will resolve this question is to analyse the cases where other equitable proprietary interest acquirers have come into conflict with the debenture holders or the receivers. It is submitted that the nature of the debenture holder's interest can be best ascertained from the result of these conflicts.

Firstly, the question of the giving of a subsequent fixed equitable interest, whether it is a fixed or floating charge. The case of re Florence Land and Public Works Co.[9] The objects of the company in that case, included the purchase of certain concessions of freehold land and buildings in the city of Florence and to execute the works authorised under this concession.

The company had under the Memorandum of Association, power to borrow and issue debentures over the property of the company. This the company did. The Court of Appeal held that the debenture was a charge over the property of the company. The question was whether it was from the outset a fixed or a floating charge. The words of the debenture were not specific in this regard. However, to determine the nature of the security the court looked at the Articles of the company and the terms of the debenture and determined it was intended to be a security on the property of the company as a going concern and was therefore subject to the powers of the directors to dispose of the property of the company while carrying on its business in the ordinary course. Jessel M.R. stated:[10]

> "It is therefore inconsistent to suppose that the moment you executed a bond or debenture you paralysed the company and prevented it carrying on its business, for if you read the words to mean a specific charge on the property of the company, then, of course, no practical use could be made of the company, and anybody with notice would be liable on that view to repay it to the mortgagee or debenture holder. That would be one extravagant result. Another would be this, that if the company is formed to build and to let and to mortgage its property, you can neither lease nor mortgage without the assent of every individual bond or debenture holder, which again, to my mind, would be extravagant."

His Honour preferred the view, which he described as a "rational" view, that the charge was subject to the powers of the directors whilst they are carrying on the business, but subject to them carrying on their business as usual. In other words,

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9. (1879) 10 Ch.530.

10. ibid., 541.

irrespective of the words of the debenture, whether the charge is fixed or floating depends upon whether it was intended that the company should be permitted to continue to carry on its business notwithstanding the charge. If so, then it is a floating charge. This is particularly important. At the risk of being repetitious, it is worth restating that whether a charge is fixed or floating depends not upon what the deed creating the charge calls the charge, but upon the nature of the interest created by the deed. The interest may be a fixed charge, that is, it is not intended that the company should be free to carry on its business free of the charge; or it may be floating. The latter will by the deed empower and authorise the company to carry on its business notwithstanding the charge. But in any event it is not what the deed calls the charge that is important, but what is the deed's limitation on the power of the company to carry on business is the important question.

In National Provincial Bank of England v. United Electric Theatres Ltd.[11] a debenture was granted by the company which purported to assign or convey all the property of the company both present and future. The debenture holders claim it was a fixed charge while the local authority who had seized the property in satisfaction of unpaid rates claimed the charge was a floating charge and it had not crystallised prior to the seizing of the property by the authority. The court found that the words of Romer L.J. in the Court of Appeal in re Yorkshire Woolcombers Assn.[12] were the authoritative definition as to when a charge is fixed or floating. The tests stated by Romer L.J.,[13] and applied in the instant case were :

> "(1) If it is a charge on a class of assets of a company present and future;
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> (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and,

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11. [1916] 1 Ch.132.
12. [1903] 2 Ch.284.
13. ibid., 295.

> (3) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns that particular class of assets..."

In the National Provincial Bank of England Ltd. case the court held the deed gave the company the power to sell and deal with its property in precisely the manner referred to by Romer L.J. in the above tests.

In Re Borax Company[14] the Court of Appeal was called upon to decide whether upon the sale of a large portion of the business and undertaking of the company the debenture charge which had hitherto been floating, became fixed. It is submitted that an important conclusion found by the trial judge and accepted by the Court of Appeal was that notwithstanding the arrangement and the sale, the company was still regarded as carrying on some part of the undertaking as contemplated by the memorandum of association. Lord Alverstone C.J. held that before a debenture holder can claim that his charge has attached to the assets of the company, he must show;[15]

> "...either that the act complained of is ultra vires, or that, to use the language of Lord Macnaughten,[16] 'the undertaking has ceased to be a going concern',or that the terms of the debenture which he holds gives him the express right to veto or negative the operations which the company are proposing to carry out within their powers."

The last aspect of this quotation involves the question of automatic crystallisation which will be referred to in Section 2 of this paper.

Suffice at this point to say that in the absence of specific prohibition, provided the undertaking is still a 'going concern', the company or its Board may do that which is permitted under its

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14. [1901] 1 Ch.326.
15. ibid., 337-338.
16. in Governments Stock and Other Securities Co. v. Manila Railway Co. [1897] A.C.81.

articles and memorandum without the floating charge thereby becoming fixed. From Re Florence and Re Borax it is clear that the sale of any of the assets in itself will not fix what was thereto a floating charge.

The same principle viz: a floating charge by definition does not prevent a company carrying on its business, was held In re Hamilton's Windsor Iron Works[17] to apply in respect of the granting by the company of a subsequent fixed charge over the same assets already the subject of a prior floating charge.

In Re Hamilton's Windsor Iron Works the company had issued debentures the effect being to charge all the undertakings of the property, and effects of the company, both present and future. Needing further funds, the company gave a fixed charge over certain of the property included in the earlier floating charge. In this particular case, counsel for the debenture holders relied strongly on the words of the deed which said that the debentures were to be a first charge. The issue before the court was firstly, whether the company could issue subsequent fixed charge debentures; secondly, whether the floating charge affected the property of the goods the subject of the floating charge so as to prevent the subsequent fixed charge being able to rank in priority to the earlier floating charge. That the company was entitled to issue a subsequent fixed charge was stated by Mallins V.C.:[18]

> 'I entirely concur in [the decision of Re Florence] and I hold it to be the law that when a general mortgage of this kind is taken, whether it be in the form of a debenture, or, as in the present case, by a general assignment of property of a commercial company, that, in my opinion, necessarily leaves that commercial company in possession of their property and for the purpose of carrying on their business in the usual way, and of doing all things necessary to enable them to carry on the business to advantage. Amongst those must necessarily be the power of borrowing for the purpose of paying wages and buying materials.'

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17. (1879) 12 Ch.D.707.

18. ibid., 710.

The Vice Chancellor held that the subsequent mortgagee was entitled in priority to the debenture holder to the property the subject of the fixed charge. As Jessel, M.R. said in the case of In re Colonial Trusts Corporation:[19]

> "It would be a monstrous thing to hold that the floating security prevented the making of specific charges or specific alienations of property, because it would destroy the very object for which the money was borrowed, namely, the carrying on of the business of the company... The fact is, the only way of making the thing workable is to treat it as what is sometimes called a floating mortgage or charge attaching on the property of the company in preference to its general liabilities, that is, its liabilities to creditors not secured by specific charges, at the moment the business is put an end to, either by the appointment of a receiver in an action instituted by the debenture-holders against the company, or at the commencement of the winding-up where the company is wound up."

The above cases and quotations were referred to approvingly and followed by North J. in Wheatley v. Silkstone,[20] where the directors of a company with power to borrow and create mortgages and issue debentures, having already issued a floating charge debenture, subsequently deposited with the plaintiff the title deeds to the company's colliery by way of security. The colliery was included in those assets the subject of the earlier floating debenture. The court held that the subsequent charge took priority over the earlier floating charge.

The floating charge therefore is a kind of security which must allow the company to trade and deal with its assets in the ordinary course of its business, which, provided the memorandum or articles so authorise, will include the borrowing of money,[21] and to secure those borrowings by the granting of a charge. It is important at this stage to note that any debenture instrument which purports to restrict the rights of the company to so carry

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19. (1880) 15 Ch.D.465.

20. (1885) 29 Ch.D.715.

21. Although a trading company has a general power to borrow see General Auction & Monetary Co. Ltd. (1889) 3 Ch.432.

its business is therefore by definition, not a floating charge debenture, and must as a result thereof, be a fixed charge debenture.

A second point to emerge from consideration of the above cases is that whatever the debenture holder has prior to crystallisation, it certainly is not a proprietary interest in the property of the company which will in any way affect the granting of subsequent proprietary interests in priority to those of the debenture holder, whether in equity or in law.

Two further authoritative statements in support of the above are found in Illingworth v. Houldsworth[22], the first being that of the Earl of Halsbury L.C. [23]:

> "...and to carry on their business exactly as if this deed had not been executed at all. It is what we mean by a floating security."

The second, that of Lord Macnaughten[24]:

> "I should have thought there was not much difficulty in finding what a floating charge is in contrast to what is called a specific charge. A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak, floating with the property which it is intended to affect until some event occurs or act is done which causes it to settle and fasten on the subject charge within its reach and grasp."

It is therefore submitted that it can be stated without question, that whatever the interest of the debenture holders until the charge crystallises, the proprietary interest of the debenture holder (if any) is such as will not affect the proprietary interests of others subsequently acquired if they were so acquired

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22. [1904] A.C.355.
23. ibid., 358.
24. ibid., 358.

through activities which are in the ordinary course of business of the company. To endeavour to establish any further the exact nature or type of the equitable interest is, it is submitted, quite unnecessary. Moreover, it can be further stated that until crystallisation, execution creditors can take the company's property free of the debenture charge. This area of priorities between debenture holders and execution creditors is comprehensively examined by Farrar.[25] However, in examining the nature of the floating charge as a basis to determining the effectiveness of automatic crystallisation clauses the cases involving disputes between debenture holders and execution creditors are well worth examination.

This examination starts with the first case where such a conflict was discussed, and that was In re Standard Manufacturing Co.[26] where the Court of Appeal stated, although obiter, that execution creditors were subject to the equity of the debenture holders and where a receiver had been appointed prior to sale by the sheriff the debenture holder prevailed. This case was discussed and followed In re Opera Ltd.[27] In this latter case the sheriff had seized goods and prior to sale, a liquidator was appointed which was held to thereby crystallise the debenture. The Court of Appeal held that the proceeds of sale of those goods were subject to the fixed charge of the debenture holders.

The next case, in chronological order, was Taunton v. Sheriff of Warwickshire[28]. Here the sheriff had seized goods and was about to sell them. The debenture holder, having obtained knowledge of the imminent sale gave notice of and commenced action to appoint a receiver: to hold the status quo until the appointment of a receiver, applied for and obtained an interim injunction. Prior to notification to the sheriff of the injunction as the sale

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25. J.H. Farrar, LL.M., Solicitor, "Floating Charges and Priorities" 38 The Conveyancer 315.

26. [1891] 1 Ch. 627 (C.A.).

27. (1891] 3 Ch. 260 (C.A.).

28. [1895] 1 Ch. 734 (Ch); [1895] 2 Ch. 319 (C.A.).

was about to be effected, the solicitor for the debenture holder paid moneys to the sheriff. It was these proceeds that were frozen in the hands of the sheriff. Kekewich J. held that the proceeds were subject to the debenture charge as they were in the hands of the sheriff when the charge fixed; viz, the appointment of the receiver. The Court of Appeal upheld that decision, but for different reasons. Lindley L.J. held that the debenture holders crystallised their debenture when they applied to the court for a receiver to be appointed and, accordingly, the sale and the proceeds therefrom were subject to the fixed equity of the debenture holders. Lopes and Kay L.J.J. upheld the decision of Kekewich J. on the ground that as the solicitor for the debenture holder had paid to the sheriff the equivalent of the sale price by way of security pending the outcome of this injunction action, there had, in fact, been no sale of the chattels. The money paid to the sheriff by the solicitor was not purchase moneys for the chattels, but

> "money deposited to abide the event".[29]

The law to that point in time was somewhat summarised in Robson v. Smith[30] where it was held that the holder of a debenture constituting only a floating security has no equity in the property of the company until the company is wound up or a receiver has been appointed. In this case a garnishee order nisi was obtained and the debenture holder gave notice to the garnishee of his interest as debenture holder. No receiver was appointed and subsequently the creditor obtained an order absolute. The garnishee paid out in accordance with the order. The court held that the notice by the debenture holder was ineffective until the charge crystallised which in this case did not happen prior to the payment by the garnishee to the garnishor.

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29. ibid., 322.
30. [1895] 2 Ch.118.

In Biggerstaff v. Rowatt's Wharf Co.[31] a company issued debentures secured by a floating charge. Subsequently the company hypothecated certain debts of the company to a creditor in satisfaction of those debts. Lindley L.J.[32] held:

> "The principal that a company can, until the debenture holders interfere, carry on its business as if the debentures did not exist."[33]

Kay L.J.:[34]

> "The debentures must be regarded as incomplete assignments which do not become complete until the time when the receiver is appointed."

In re Roundwood Colliery[35] the company was the lessee of premises the deed creating which gave the Lessor the power to distrain for unpaid rent. The company had also issued a floating charge debenture. The Court of Appeal held that the distress, having been made before the commencement of the winding-up of the company, and before a receiver was effectively appointed, was valid against the debenture holder.

It is now necessary to refer to the proposition developed earlier in this paper[36], that the floating charge is the kind of security which must allow the company to trade and deal with its assets in the ordinary course of its business. Can it be said the forced realisation of money by the sale of the company's assets by execution is a dealing with the assets of the company in the ordinary course of its business. Upon this problem there are two views: firstly, that it is not the levying of

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31. [1986] 2 Ch. 93 (C.A.)

32. ibid., 101.

33. It is to be noted for later discussion that the deed creating the floating charge provided for automatic crystallisation. Notwithstanding the clause, Lindley L.J. refers to the necessity of interference by the debenture holders to cause the charge to fix.

34. ibid., 106.

35. [1897] 1 Ch. 373 (C.A.)

36. supra.

execution which is the action in question, but the company incurring debts in the normal course of business, which debts, if not paid, will in the normal course render the company's assets liable to execution.[37] The other view is that such action is not in the normal course of dealing and thereby renders the debenture holders entitled to crystallise or if there is an automatic crystallising clause, and it is held to be effective as such, then the debenture will crystallise and the execution creditor will take subject to the equity of the debenture holder.

It is submitted the first of the above views is correct. The second does not appear to be supported by the cases. For example, in Biggerstaff v. Rowatt's Wharf Co.[38] the obtaining of garnishee order absolute was not regarded as being not in the ordinary course of business so as to crystallise a debenture containing an automatic crystallisation clause.

Again, in Davey v. Williamson[39], which is the subject of critical comment later in this paper, the debenture which contained an automatic crystallising clause was not held to have crystallised because of an execution process against the company. In this case, Lord Russell C.J. (delivering the judgment of the Court) said:[40]

> "The company as a going concern had come to an end and although the due date for the debentures had not arrived, the holders were entitled to intervene to protect their security."

In this case the debenture holders were held to have a fixed interest in the property notwithstanding that no receiver had been appointed.

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37. See Re Roundwood Colliery case supra.

38. supra.

39. [1898] 2 Q.B. 194 (C.A.).

40. Ibid., 200-201.

In Evans v. Rival Granite Quarries[41] the debenture did not contain an automatic crystallising clause, but provided that the moneys became due and payable and the right of the debenture holder to appoint a receiver occurred upon the happening of any of several events including the levying of execution by a creditor. The creditor in this case obtained judgment and a garnishee order nisi. On application to the court for the order absolute, the debenture holder, not having yet appointed a receiver, opposed the order on the ground that the debts were subject to the equitable interest under the debenture. The Court of Appeal unanimously granted the order absolute upon the ground that until the debenture crystallises, the property is able to be dealt with, free of the floating charge. As to whether that dealing must be in the ordinary course of business, it is submitted that from the facts of not only this case, but also the earlier discussed cases,[42] this cannot be a limitation. Or, if it is seen as a limitation, then the actions of a creditor levying execution can not be regarded as 'not ordinary'. It may well be however, that under the terms of the deed such action by the creditors may be a ground to crystallise the debenture but whether this can happen automatically upon such creditor action being taken, or serve only as a ground for the appointment of a receiver will be discussed in the next section of this paper.

In any event the Court of Appeal in Evans case allowed the order absolute to issue. The debenture holder in that case had argued two points: firstly[43], "that the rights of the debenture burdens each piece of the company's property and assets with the debenture holder's rights and prevents the company from dealing with it"; and, secondly, by giving notice to the garnishee, the execution creditor was subjected to the debenture

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41. [1910] 2 K.B.979.

42. In re Standard Manufacturing Co., supra., In re Opera Ltd., supra., Taunton v. Sheriff of Warwickshire, supra., Robson v. Smith, supra., Biggerstaff v. Rowatt's Wharf Co., supra., In re Roundwood Colliery, supra.

43. ibid., 995.

holder's rights. By granting the order each of their Lordships must have impliedly dismissed both arguments. However, Fletcher Moulton L.J. formulated and expressly dismissed both arguments.

Finally, in regard to execution creditors there is some problem with two cases.[45] Lest non mention be construed as an oversight, an attempt to explain these cases will be made.

Firstly, the case of Norton v. Yates[46] which although follows rationally from the cases already discussed in this area, leads to the problems in the two following cases. In Norton v. Yates a company issued a floating charge debenture. A judgment creditor obtained a garnishee order nisi. Two days later, and before order absolute, and before payment by the garnishee, a receiver was appointed. The court held that the garnishee order nisi did not operate as an assignment in equity. Accordingly, the garnishor was subject to all other equities. The appointment of the receiver gave the debenture-holders a fixed interest which clearly took priority to the equity of the garnishor. This would appear to fit in with Robson v. Smith[47] which held that the garnishor will take priority unless the debenture crystallises before the order absolute is made. However, the problem in Cairney v. Back takes its root from the interpretation of Robson v. Smith by Warrington J. in Norton v. Yates. Warrington J. states that Robson v. Smith is distinguishable from Norton v. Yates because in Robson v. Smith the judgment creditor obtained payment from the garnishee before a receiver was appointed. Whereas it is submitted that proper distinction was that the garnishee order absolute was obtained before a receiver was appointed. In Cairney v. Back the receiver was appointed after the order absolute and before payment by the garnishee. The court held that the receiver took priority to the garnishor.

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45. Cairney v. Back [1906] 2 K.B.746, and Duck v. Tower Galvanising [1901] 2 K.B. 314.

46. [1906] 1 K.B. 112.

47. supra.

It is submitted that the cause of this divergence results from differing views of the effect of the garnishee order itself. The courts in Robson v. Smith and Cairney v. Back relied on In re Combined Weighing and Advertising Machine Co.[48] as authority for the proposition that a garnishee order is not an assignment of the debt. This is no doubt acceptable. In that case the court held that a garnishor is not entitled to petition for winding up the garnishee for failure to pay over the money the subject of the order. In re Combined Weighing and Advertising Machine Co. the court relied for authority on the decision of the Court of Appeal in Chatterton v. Watney[49] that a garnishee order does not operate as a transfer of the debt. With respect however, it is submitted that such an answer begs the question. The issue is not whether the debt is assigned or transferred by the garnishee order to the extent that the garnishor can petition for winding up (as in the In re Combined Weighing case). It is submitted that the issue is whether the garnishee obtains any interest in the debt. The interest may not be one of an assignee or transferee but surely it is one of a chargee or licence. As Cotton L.J. says In re Combined Weighing case:[50]

"...it merely gives the garnishor a lien upon that debt."

It is submitted that the equitable lien, enforceable in equity by way of equitable charge, becomes a fixed equitable interest upon the garnishee order absolute. Such a view rationalises with the decision of Robson v. Smith and Norton v. Yates[51] - although perhaps not the reasoning of Warrington J. in the latter case. It does not however, rationalise with Cairney v. Back[52]. It is submitted that Cairney v. Back is wrong. As

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48. (1889) 43 Ch. D. 99 (C.A.).
49. (1881) 17 Ch. D. 259
50. ibid., 104.
51. supra.
52. supra.

Fletcher Moulton L.J. states in Evans v. Rival Granite Quarries Ltd.[53] in reference to Cairney v. Back

> "[it] contains dicta that I cannot reconcile with what I believe to be the law".

The decision in Duck v. Tower Galvanising[54] again concerned the question of priority between an execution creditor and a debenture holder. In this case the debenture deed did not contain any provision for the charge to attach or fix automatically on the happening of certain events, but did provide that the debt should become repayable and a receiver was able to be appointed upon certain events happening including the levying of execution by a creditor. It appeared that no receiver was appointed, yet the court held that the debenture holder prevailed over the execution creditor.

Before the court, counsel for the execution creditor argued only the question of the validity of the debenture as a question of vires. In a brief judgment which for the most part dealt with the issue of vires, the judge regarded the issue of priority between the execution creditor and the debenture holder as being settled by In re Standard Manufacturing and In re Opera[55] and considered that those cases gave priority to the debenture holder notwithstanding the debenture does not appear in this case to have crystallised.

It is submitted that Duck v. Tower Galvanising is incorrect. As an attempt to justify the decision, it could be argued that in Duck v. Tower Galvanising a receiver may have in fact been appointed. The facts are not clear in this regard. It does appear that the debenture holder was entitled to appoint any person in writing to be the receiver. In the facts here, the debenture holder was a fellow named Callund, and in the action against the creditor this fellow acted for himself and in his own name. It may be argued, although not entirely convincingly, that a debenture holder who acts for himself, and as such intervenes does not need to appoint himself in writing, such a requirement being necessary only when he appoints someone else to act for him. In any event,

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53. [1910] 2 K.B.979,997.
54. [1901] 2 K.B.314 (Q.B.)
55. supra.

Duck v. Tower Galvanising and Cairney v. Back for the purposes of this paper are regarded as wrongly decided.

By way of summary therefore, it can be said from the analysis of the above authorities that while the charge floats, the company can give subsequent specific mortgages, and sell assets free of the charge. Furthermore, execution creditors provided the moneys from the bailiff's sale have been paid, or the garnishee order absolute has been granted before the charge crystallises, the creditor will prevail. It is submitted this analysis of the position of persons dealing with the property of the company is the most useful way of understanding the nature of the floating charge prior, at, and post crystallisation.

This section of the paper dealing with the nature of the floating charge as such would not be complete without reference to what is sometimes referred to as 'the licence theory'. The licence theory states that the floating charge is in effect a fixed mortgage with a licence for the company to deal with the goods subject to the mortgage. It is conceded by commentators in support of the licence theory that the licence must be subject to certain limits; and, if the company acts outside these limits, then by such acts the company is not able to displace the fixed mortgage of the debenture holder. There are several grounds for arguments against this theory. Firstly, the theory applied strictly would at times grant the debenture holder a fixed charge due to certain acts being outside the limits of the licence, and subsequently being a floating charge enabling the company to deal with property in accordance with the terms of the licence. That is, the debenture would be fixing and unfixing according to the nature of the acts that the company was performing. It is submitted that a floating charge crystallises or fixes but once, and any theory to the contrary is most undesirable. Secondly, the licence theory must be tested among other things in regard to the position of a

creditor who has completed execution before crystallisation. It follows from the theory that the company is not permitted to allow judgment creditors to levy execution against the property of the company. Hence, any such rights of an execution creditor must be subject to the fixed charge of the debenture holder. However, as already discussed[57], this is not the position.[58] Thirdly, the theory that a debenture is a specific mortgage subject to a licence to the company to carry on certain acts has been expressly discredited. In Evans v. Rival Granite Quarries Limited[59] Buckley L.J. stated:

> "The outcome of the decisions may be thus summarised. A floating security is not a future security; this is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. 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 event occurs or some act on the part of the mortgagee is done which causes it to crystallise into a fixed security."

Similar statements have been made in other cases.

It is again submitted that the determination of the nature of the floating charge is better achieved by analysis of the cases dealing with the priorities between the debenture holder and other categories of persons dealing with the company's assets than by analysing various theories. Suffice to say that the licence theory does not lie happily with the analysis of the cases determining priority between execution creditors and floating charge holders. It is however, necessary to point out though

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57. supra.

58. See In re Standard Manufacturing Co. supra., In re Opera Ltd. supra., Robson v. Smith, supra., and Biggerstaff v. Rowatt's Wharf Co. supra.

59. [1910] 2 K.B. 979, 999.

that the problem does not arise from the conception of the company having a licence or right, if that licence or right is seen as the right to carry on its business. It is said that the problem that arises is whether the charge is a fixed equitable interest which does not affect any transaction carried out intra vires the licence; or, whether it is a mortgage of future assets which shifts to charge the assets of the company such as they are from time to time.

It is respectfully submitted that neither view is as helpful in determining the nature of the floating charge as the analysis of the cases set out above. Furthermore, from that analysis it would seem that it is only upon crystallisation that the charge holder obtains an effective interest. Whether one talks in terms of a permission, a right, or even a licence, it does seem apparent that that in fact is what the company has: viz. a right or permission to carry on its business until the floating charge crystallises. Without such a right, the charge, by definition is not a floating charge.[62] The question is, when does such a charge crystallise? It is to this question that we now turn.

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62. National Provincial Bank of England Ltd. case, supra., see also the obiter statements of Slade J. in Siebe Gorman & Co. Ltd. v. Barclays Bank Ltd. [1979] 2 Ll. Rep. 142.

2. CRYSTALLISATION

'Crystallisation' of a floating charge is the term used to describe the fixing of that charge to specific assets of the company at a specific date. The issue is whether such crystallisation can take place as an automatic event pursuant to a clause in the debenture deed? Below is the 'automatic crystallising clause' in a commonly used commercial form available in Auckland.

> "The principal sum hereby secured or the balance thereof for the time being outstanding becomes payable when the security hereby conferred attaches becomes fixed and crystallises upon the happening of any of the following events:
>
> (a) If default is made for a period of fourteen days in the payment of any interest or any other moneys secured by this debenture;
>
> (b) If a petition is presented or an effective resolution is passed for the winding up of the Company;
>
> (c) If the Company suspends payment or ceases to carry on business;
>
> (d) If any of the conditions necessary to render the Company liable to be wound up exists and continues for a space of fourteen days;
>
> (e) If it appears from the balance sheet of the Company or by a certificate of the auditors of the Company that liabilities of the Company (secured and unsecured) to its creditors exceed its assets;
>
> (f) If any distress is levied or execution is issued upon any asset of the Company for any debt or rent due or owing by the Company;
>
> (g) If default is made in the observance or performance of any of the covenants, conditions, agreements or stipulations contained or implied in this debenture;
>
> (h) If a receiver of the property and assets of the Company is appointed;

(i) If the Company by effective resolution alters, amends or varies or adds to or purports to alter, amend, vary or add to its articles of association without the prior written consent of the Lender."

With reference to (g) above, there is in the same debenture deed an obligation on the company not to create any mortgage or charge in priority to or pari passu with this security without the prior written consent of the lender. Furthermore, there are such requirements on the Company to ensure the property is insured, and to deliver the insurance policy to the Lender. To pay punctually all premiums and not later than noon on the day on which the premium falls due, to deliver the receipt to the lender. There is a requirement on the Company at all times to keep proper books of account, supervised by a public accountant. Perhaps the piece de resistance:

> "The company shall duly and punctually comply with and observe all statutes now or hereafter in force, and all regulations and by-laws thereunder and all requirements and orders of any authority, statutory or otherwise, in all cases in which the non-compliance with them or non-observance of them would or might impose some charge or liability or disability upon the mortgaged premises or any part of them, or prejudicially affect the security."

The issue becomes whether failure to observe some or any of these clauses, which may well be thought of as minor covenants, will pursuant to the specific clause of the debenture, render the floating charge in fact a fixed charge from the point in time of the breach of the covenant in the debenture. That is, the issue is whether the parties can by contract provide that the floating charge will crystallise on the happening of any particular event, irrespective of the nature of severity of the event chosen. It is submitted that the resolution of this issue lies again in an analysis of the nature of the floating charge to determine whether the concept of automatic crystallisation fits into the conceptual nature of the charge. Again, it is submitted that the most preferable way to determine the conceptual nature of the charge is by analysis of various statements of courts when giving effect or otherwise to such a charge.

In Re Yorkshire Woolcombers Association Limited[62] where Vaughan Williams L.J. states that:[63]

> "It is plain that when you start with your floating security given to the debenture-holders, the whole basis of the arrangement is that the business is going on, and should go on, until the debenture-holders, according to the terms of the deed, intervene."

His Honour Romer L.J. states that there are three characteristics to a floating charge:[64]

> "(1) If it is a charge on a class of assets of a company present and future;
>
> (2) If that class is one which in the ordinary course of the business of the company will be changing from time to time; and,
>
> (3) If you find that by the charge it is contemplated that until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."

In The Governments Stock and Other Securities Investment Company Limited v. The Manila Railway Company Limited[65] there was in fact an automatic crystallising clause. A condition endorsed on the debentures provided that 'notwithstanding the said charge the company might in the course and for the purpose of its business sell or otherwise deal with its property until default should be made in payment of interest or three months after the same should have become due, or until an order or resolution for winding up'. In other words the effect of the debenture deed was that the right of the company to carry on its business, which is the essential attribute of a floating charge, ceased upon the happening of a particular event. That is, on the happening of this particular event, the charge became fixed. After an instalment of interest had been due more than

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62. [1903] 2 Ch. 285.
63. ibid., 292.
64. ibid., 295.
65. [1897] A.C. 81.

three months, but before the debenture-holders had taken any step to enforce their security, the company by an issue of bonds mortgaged specific assets. The court held notwithstanding the automatic crystallisation clause that until the debenture-holders took some specific steps to prevent the company from dealing with its property, the company was free to create specific mortgages and the debenture-holders were subject to the fixed subsequent mortgage. The case is of significance and warrants close examination of each of the judgments of the members of the House of Lords.

Lord Halsbury L.C. saw the problem as simply the construction of the particular terms of the instrument in question. However, it appeared to His Lordship that on the plain meaning of the terms, the charge would be so absolutely unworkable in its operation that he did not believe nor think that the parties could have contemplated such a condition of things as was stated in the instrument.

The Lord Chancellor was of the opinion that it was much more reasonable to suppose that there was to be no interference with the power of the company to treat the charge as a floating security until the intervention of the debenture holder. Accordingly, he so interpreted. Whereas, Lord Macnaughten approached his interpretation of the specific clause of this case on the assumption that there had to be an act or intervention by the debenture holder to crystallise the debenture. His construction of the clause therefore became simply that the clause provided a time at or after which the debenture holder was entitled to intervene.[66]

> "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. His right to intervene may, of course, be suspended by agreement. But if there is no agreement for suspension, he may exercise his right whenever he pleases after default."

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66. ibid., 86.

Referring to the specific words of the clause in question,[67] ..."the company shall be at liberty in the course and for the purpose of its business to use, employ, sell, lease, exchange or otherwise deal with any part of its property until default shall be made in payment of any interest hereby secured for the period three months after the same shall have become due, or until an order of some court of competent jurisdiction shall have been made, or a special resolution has been duly passed winding up the said company." Lord Macnaughten saw this clause as stating that when the particular period came to an end, the company lost its right to carry on its business, but so long as the default lasts, the business may still be carried on, not as of right, but by the sufferance of the debenture holders and at its mercy. Notwithstanding the specific words of the clause, His Lordship considered the position if the opposite meaning was given the clause:[68]

> "It is impossible to suppose that they could have meant that at the end of the period of grace the floating security should be turned into a fixed and binding charge, and that the business without being stopped should be allowed to drag on in a paralysed helpless condition."

Shand L.J. was also of the opinion that the debenture holder must intervene. He states:

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67. Prof. J.H. Farrar: "The Crystallisation of a Floating Charge." (1976) 40. The Conveyancer 397, 402 argues that the words of the clause in the Governments Stock v. Manila Railway case, due to a portion of the clause being omitted from the deed, did not amount to an automatic crystallisation clause. It is respectfully suggested that the clause included in the deed gave the company the authority to deal with its assets "until default shall be made". That is, the authority required to make the clause a floating charge ceased on the happening of a certain event, which event in fact transpired. It is submitted therefore that the Houses of Lords was in that case determining the effect of an automatic crystallising clause.

68. ibid., 87.

> "I should have very great difficulty in any case, even upon the construction of the instrument which has been presented, in holding that if the creditors in these debentures lay by and took no step whatever to arrest the business, or to put a receiver in charge of the business, they could affect anyone in the transaction of business with the company."

Lord Shand L.J. avoided having to face the issue squarely by placing a construction on the clause entirely different from the plain meaning of that clause. This avoided having to find as a matter of law that intervention by the debenture holders was required to crystallise the debentures. In other words, those judges who saw the issue as a matter of construction were at pains to construe the clause in a way, notwithstanding the clear meaning of the clause to the contrary, that met with their expectations of a floating charge.

It is submitted that Goode[69] is correct when he states that the test of a floating charge is not the shifting nature of the security as such, but more, the chargee's contractual commitment not to intervene in its management before the occurrence of a crystallising event. It is clear from the earlier discussion in this paper that in deciding whether a charge is a fixed charge or a floating charge, the court looks not so much at words of the mortgage, but whether or not it is contemplated by the charge holder that the company should be free to deal with its assets in carrying on its business.[70]

The lynch-pin of all arguments in favour of the concept of the floating charge crystallising upon the happening of a specified event is that the floating charge is a consensual, contractual arrangement between the company and its debenture holder. From this it would follow that whether the charge can crystallise automatically upon the happening of any of a number of

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69. R.M. Goode "The Death of Insolvency Law", (1980) 1 Co. Law. 123.

70. See In re Yorkshire Woolcombers Assn. supra., Illingworth v. Holdsworth supra., and National Provincial Bank of England Ltd. v. United Electric Theatres Ltd. supra., see also Re Crompton supra.

events, is purely a matter of construction. However, it will be recalled that two judges in the House of Lords in Governments Stock v. Manila Railways[71] stated that they could not accept a construction of a clause if that construction resulted in the debenture holder not having to intervene to crystallise his security. Both these judges then went on to construe the clause, notwithstanding that the words of the clause were clear, to mean precisely the opposite to the plain and clear meaning of the clause itself. They held that the debenture holder was still required to intervene to crystallise his charge. This view was subsequently endorsed and restated in the Court of Appeal in the case of Evans v. Rival Granite Quarries Limited[72] where Fletcher Moulton L.J. when called upon to examine the precise nature of the rights of the debenture holder found from examination of several of the earlier cases referred to already in this paper, that the courts realised that in the case of a security of this nature, it was impossible to come to any other conclusion than that it was intended to leave the company free to carry on its business until the time arrived when the debenture holders enforced the security upon the company's assets and undertakings. His Lordship stated:[73]

> "I do not deny that in the earlier cases the actual words of the particular document may have influenced the Courts and enabled them to draw the conclusions which they did. But at an early period it became clear to the judges that this conclusion did not depend upon the special language used in the particular document, but upon the essence and nature of a security of this kind."

His Lordship then stated:

> "This view is expressly accepted in later decisions and is now accepted law."

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71. supra.
72. [1910] 2 K.B. 979.
73. ibid., 993.

In other words, a floating charge is not entirely a creature of contract, but a creature of the law of equity as developed in the courts towards the end of the 19th Century. It has very specific qualities and attributes which are not able to be altered. In this regard it is pertinent to note that apart from companies, the law of equity knew of no such charge as a floating charge which gave the kind of 'dormant' proprietary interest in future property. It was held in Holroyd v. Marshall[74] that future acquired property, when acquired by the mortgagor, immediately became subject to the fixed charge of the mortgagee. This would preclude the mortgagor from giving any mortgage or charge in priority to that charge. It has been seen that this is not the case with a debenture. Hence, a floating charge debenture is an equity, created by the courts of equity, and not able to be tampered with, at least in its essential attributes. It is submitted that an essential attribute of the debenture is the question of when, and how it becomes a fixed charge. It is apparent from the cases referred to that one of the essential attributes of the floating charge is that the company should be able to continue carrying on its business and to deal with its assets "as if the charge did not exist".[75] Should a debenture holder in this debenture contract, restrict the activities of the company to an extent that it cannot continue to carry on its business, then irrespective of what the debenture holder claims to have, he will not have a floating charge debenture as it is known in equity.

The first case to support the theory of 'automatic crystallisation' is Re Manurewa Transport[76] in which Speight J. held that a clause which provided that the moneys secured by the debenture should become immediately due and payable and the charge thereby created should immediately attach and become fixed, was effective to cause an automatic crystallisation of the floating charge upon the

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74. (1862) 10 H.L.C. 191.

75. See Biggerstaff's case supra., and Illingworth v. Houldsworth supra.

76. [1971] N.Z.L.R. 909.

happening of any of the specified events. His Honour came to this conclusion first, by distinguishing the words of the debenture deed in Evans case from those of the instant case. It would seem from the judgment in Re Manurewa that His Honour's argument was along the following lines: because the words of the Evans debenture were different from that in this case, I am able therefore to disregard the comments of two of the Law Lords in their judgments wherein they summarise the events of the previous twenty five years of cases through the period in which the floating debenture charge developed.

With the greatest of respect for Speight J., it is submitted that the words used by each of their Lordships in Evans case, were not provoked by the words of the debenture in that case, but more, were considered statements of principle following close analysis of the previous leading cases, including one Court of Appeal decision and one House of Lords decision where the debentures in issue contained automatic crystallisation clauses. Furthermore, in particular the decision of Governments Stock v. Manila Railways the argument of counsel was directed solely at the issue of automatic crystallisation. Speight J. found authority for his view that crystallisation may be self generated or at least, debtor generated, in the judgment of Buckley L.J. in Evans, which approves the case of Davey v. Williamson.[77] However, it is submitted that upon analysis, Buckley L.J. was not so much approving Davey v. Williamson but endeavouring to explain it. He states that the nature of the floating charge security is a mortgage presently affecting all the items expressed to be included in it. Further,there are a number of various ways in which such a debenture may crystallise: they being the appointment of a receiver, the company going into liquidation and a liquidator being appointed, or any event which is defined as bringing to an end the licence[78] of the company to

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77. [1898] 2 Q.B.194.

78. It is submitted that the use of the word "licence" in this instance, is not used in support of the "licence theory" discussed above, but is used as a synonym to the word "right" or "permission".

carry on business. It must be conceded that this statement by Buckley L.J. causes some difficulty to the opponent of the concept of automatic crystallisation. However, Buckley L.J. is in a minority in Evans on this issue, and as Speight J. points out, the statements in Evans in respect of crystallisation are obiter.

It is submitted that Buckley L.J.'s analysis of the case of Davey v. Williamson[79], relied upon by Speight J. in Re Manurewa, does not stand analysis.

In Davey v. Williamson the debenture charge provided that "the principal moneys hereby secured shall become payable immediately on the happening of any of the events hereinafter specified, and also all right of the company to deal for any purpose whatsoever with any of the property shall forthwith cease on the happening of any such events". In a further condition endorsed on the debentures, it was provided that until the moneys thereby secured should become payable, the debenture should be floating security and it was a stipulation that the company should not before payment of the debentures create any charge to the prejudice of those debenture holders and no part of the property subject to that debenture should be dealt with except in the ordinary course of business of the company. The company got into difficulties and was unable to discharge its obligations. The plaintiffs obtained a judgment and execution was issued under which the Sheriff seized certain goods of the company which were subject to the charge of the debenture-holders. The issue became whether the debenture-holders had a fixed interest in the goods. The judge at that instance had held that the debenture-holders' claim failed for two reasons. First, that seizure of the company's goods under execution was a dealing with the goods in the ordinary course of business and therefore did not contr-vene the rights of the debenture-holders; and secondly, that the rights of the debenture-holders had not become 'crystallised'.

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79. supra.

Lord Russell of Killowen C.J. delivered the judgment of the Court. He held that the debenture-holders prevailed against the execution creditors. The reason, succinctly stated in the judgment, was that the business of the company had ceased.

> "Nor is the debenture-holder prevented from asserting his charge upon the property in the circumstances of this case. The company as a going concern had come to an end, and although the due date of the debentures had not arrived, the holders were entitled to intervene to protect their security."[80]

The question for consideration is what was in the mind of the Court when they referred to the right of the holder to intervene to protect their security. The judgment states that the debenture holders were neither bound to apply for a receiver or to proceed with a view to winding up of the company. However, the Court makes it quite clear that the debenture-holders have to do something:

> "They are entitled to say to the Sheriff 'the goods seized are validly charged to us and you cannot sell them to the prejudice of our security'."[81]

It bears to recall that there was an 'automatic crystallisation clause' in Davey v. Williamson. The Court chose not to rely on, refer to, or invoke the clause. The Court preferred to say that the debenture-holders became then entitled to intervene to protect their security. It is therefore submitted, with respect, that Speight J. was wrong to refer to the case as being support for the principle of 'automatic crystallisation'. It is submitted that Davey v. Williamson, while not arguing against 'automatic crystallisation', certainly does not support the concept.

In the course of his judgment in Re Manurewa, Speight J. stated that he considered to be wrong the view of most text book

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80. ibid., 200 (emphasis added).

81. ibid., 201.

writers who say crystallisation does not take place until the debenture-holders intervene. It is submitted that Davey v. Williamson is in fact support for this view as expressed by most text book writers.

Speight J. discounts the statements of Vaughan Williams L.J. and Fletcher Moulton L.J. in Evans v. Rival Granite Quarries Limited[82] wherein their Lordships state that debenture-holders must intervene. His Honour discounts this statement by distinguishing the terms of the Evans' debenture deed. It is submitted that the statements of their Lordships are general statements which they intended to apply to debentures as a class of security rather than to the debenture deed the subject of the Evans case. Furthermore, Speight J. makes no mention of the cases of Governments Stock v. Manila Railways[83], and Biggerstaff v. Rowatt's Wharf Co.[84] the debenture deeds in which contained automatic crystallising clauses. In Governments Stock case, Lord Halsbury L.C. after direct argument of counsel on the issue:[85]

> "It is much more reasonable to suppose that there was to be no interference with the power of the company to treat this as a floating security until the intervention of those things, which were familiar to both parties, might and could at the option of the parties put an end to any such transaction at all."

And Lord Macnaughten:[86]

> "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."

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82. Supra.
83. Supra.
84. Supra.
85. ibid., 85, 86.
86. ibid., 86.

In Re Manurewa Speight J. relies on the explanation of Davey v. Williamson by Buckley L.J. in Evans case. No reference is made to the different view of Davey v. Williamson expounded by Fletcher Moulton L.J., again in Evans case.[87] However, Fletcher Moulton L.J. states:[87]

> "[that Davey v. Williamson is] a very peculiar case, in which conclusions based upon the special language of the trust deed are mixed with conclusions derived from more general rules of law. I must confess that I have great difficulty in understanding the ground of the decision. I incline to think that the Court considered that the floating charge had ripened into a fixed charge because the company had ceased to carry on business, so that there was ground for contending that a change in the character of the charge had taken place."

Speight J.'s reference to the statement of North P. in Paintin and Nottingham Limited v. Miller Gayle and Winter:[88]

> "...until some event occurs or some act on the part of the mortgagee is done..."

is a reference to the statement of Lord Macnaughten in Illingworth v. Holdsworth:[89]

> "A specific charge, I think is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

It is submitted that the inclusion of the words "some event occurs" cannot be extended to include the 'automatic crystallising events'

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87. ibid., 997.

88. [1971] N.Z.L.R. 164, 168.

89. [1904] A.C. 355, 358.

that we know today. The basis of this submission is that Lord Macnaughten is restating, without demur from, what he had earlier said in the Manila Railway case where, notwithstanding an automatic crystallisation clause, he held the charge not to be crystallised. In other words if Speight J. is correct in assuming that North P. was referring to some defined event in addition to those accepted events of ceasing to carry on business, winding up, or the appointment of a receiver, then North P. was using these words, the same words, in a different sense than that of Lord Macnaughten in Illingworth v. Houldsworth.

The only other authority, such as it is, for the concept of automatic crystallisation apart from Davey v. Williamson is Buckley L.J. in Evans v. Rival Granite Quarries. It is submitted that Buckley L.J. is wrong in this instance. Besides citing Davey v. Williamson, Buckley L.J. also relies on the case of Geisse v. Taylor[90]. However, it is submitted that this case is inappropriate as authority for his proposition. In that case, upon execution by an execution creditor, the debenture holder appointed a receiver and claimed the goods under its debenture. It was held that the security had become specific and that the debenture holder was entitled to succeed. This seems to be in accordance with the general principles that an execution creditor will take subject to all equities, and if the debenture fixes before the sale of the goods and payment of the sale proceeds thereof to the execution creditor, then the debenture holder will prevail. It is submitted that this case is not authority for automatic crystallisation. His Lordship then refers to Norton v. Yates[91] and the case of Cairney v. Back[91]. It is submitted that these cases also are not authority for automatic crystallisation.

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90. [1905] 2 K.B. 658.

91. supra., where the cases are the subject of analysis.

Furthermore, Buckley L.J. refers to his own earlier decision In re London Pressed Hinge Co.[92] This case concerned an application by a debenture-holder for the appointment of a receiver.[93] The debenture holder made application on the ground that although nothing was presently owing on the debenture, the security was in jeopardy. The jeopardy alleged was the fact that a creditor had obtained judgment and was about to issue execution. In analysing the position of the judgment creditor before and after the appointing of a receiver Buckley J., as he then was, said that any execution creditor will take subject to the rights of the debenture-holder, and these rights are the same whether the debenture has crystallised or not. In so saying His Honour purports to be following In re Standard Manufacturing Co.[94] and In re Opera Ltd.[94] It is submitted that this view is clearly erroneous, and what is more, demonstrates a mistaken understanding as to the nature of a floating charge prior to and after crystallisation.

Finally, in regard to Re Manurewa, it is perhaps useful to compare the following two statements. The statements show the conceptual difference between Speight J. in Re Manurewa and Fletcher Moulton L.J. in Evans case in relation to the nature of the floating charge. It is submitted from earlier analysis of the cases the view of Fletcher Moulton L.J. is to be preferred.

Firstly, Speight J.:[95]

> "After all, a floating charge is not a word of art, it is a description for a type of security contained in a document which may provide a variety of circumstances whereupon crystallisation takes place".

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92. [1905] 1 Ch. 576.

93. The deed in this case did not contain an automatic crystallisation clause.

94. Supra.

95. ibid., 917.

And secondly, Fletcher Moulton L.J.:[96]

> "I do not deny that in the earlier cases the actual words of the particular document may have influenced the Courts and enabled them to draw the conclusions which they did. But at an early period it became clear to Judges that this conclusion did not depend upon the special language used in the particular document, but upon the essence and nature of a security of this kind."

In the recent Canadian decision of the Queen v. Consolidated Churchill Copper Corp. Limited[97] Berger J. at first instance was called upon to determine the right of competing claims between the Province under the Mineral Royalties Act (1974) B.C. and the defendant, Brameda Resources Limited under its debenture. The case for the Province was based on the decision of Montreal Trust Company v. The King[98] wherein it was held, as it would no doubt be in New Zealand, that until crystallisation a statutory lien has priority over a floating charge. Accordingly, the issue was whether the charge had crystallised at the time the lien arose. The terms of the debenture provided that it be a first floating charge over all the property of the company ....'provided that such floating charge shall in no way hinder or prevent the Company (except as hereinafter provided) until the security hereby constituted shall have become enforceable from selling, alienating, assigning, leasing, mortgaging, charging, pledging, or otherwise disposing of or dealing with the subject matter of such floating charge in the ordinary course of its business...'. This clause states clearly that the authority of the company to carry on its business in the normal way automatically terminated upon the debenture becoming 'enforceable'. There were certain situations set out on the occurring of which the debenture became enforceable. Such a situation developed prior to the

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96. ibid., 993.

97. 90 D.L.R. (3d) 357.

98. [1924] 1 D.L.R. 1030.

lien of the Province attaching. Berger was referred to all the text books and relevant cases[99]. His Honour held that the debenture-holder had to intervene to terminate the company's authority to carry on business. The Court came to this conclusion after considering all the cases and the policy considerations involved. In regard to the policy aspects, His Honour stated:[100]

> "Brameda sought to have it both ways; to obtain priority over the Province's lien without putting Churchill into receivership. This shows the parlous state of affairs which would result if the concept of self generating crystallisation were to be adopted. The requirements for filing by a receiver under the Companies Act would be rendered a dead letter. The company would not know where it stood; neither would the company's creditors. How is anyone to know the true state of affairs between the debenture holder and the company unless there is an unequivocable act of intervention?"

Perhaps a particularly pertinent question is asked:[1]

> "How can it be said that the default by the company terminated its licence to carry on business when in fact it was allowed by Brameda to carry on business for three years thereafter?"

As His Honour stated, this would allow the debenture holder to structure things in such a way as to render himself immune from execution.[2]

Then, looking at the legal basis of automatic crystallisation, His Honour went on to say:[3]

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99. including Re Manurewa (supra.) a large portion of the judgment of which was quoted verbatim in the judgment of Berger J.

100. ibid., 369.

1. ibid., 369.

2. a similar proposition by the debenture holder was also rejected in Evans' case supra., Vaughan Williams L.J. at 989 and Fletcher Moulton L.J. at 995.

3. ibid., 369.

> "It is my view that neither in the older cases nor in the recent cases nor in the exigencies of policy, is there any justification for the adoption of a concept of self generating crystallisation."

With this view the writer respectfully agrees.

In a recent article McLauchlan[4] argues in favour of "automatic crystallisation". The arguments advanced are firstly, Davey v. Williamson[5]. It has been already agreed that this case is not such authority at all. In fact, quite the contrary. The court held that the debenture there crystallised because the company ceased to carry on business; and not pursuant to the automatic crystallisation clause in the debenture.

Secondly, that Evans' case is not authority for the proposition that the debenture-holder must always intervene, because, in that case there was again no 'automatic' clause. Surely this must leave Buckley L.J.'s comments and observations as much obiter as the opposite views of Fletcher Moulton and Vaughan Williams L.JJ. However, the author, like Speight J. and Buckley L.J. overlook completely the persuasive authority of Governments Stock v. Manila Railway.[6]

Boyle[7] set out what the writer considers to be persuasive policy considerations against 'automatic crystallisation' which essentially revolve around the 'false situation' represented to other creditors that such a proposition would create.

Perhaps the position in law, notwithstanding the above discussion, is best summarised by reference to the law of agency. The floating charge is effectively the charge holder authorising

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4. D.W.McLauchlan; "Automatic Crystallisation of a Floating Charge", 1972 N.Z.L.J. 330.
5. Supra.
6. Supra.
7. A.J. Boyle: "The Validity of Automatic Crystallisation Clauses", (1979) J.B.L. 231.

the company to continue the management of its assets and to deal with them free of the charge. It is submitted that it is a basic principle of agency law that third parties who have become aware[8] of the existence of the authority are entitled to assume its continuance until steps are taken to bring its termination to their notice. Such steps would include the passing of the special resolution to wind-up or the appointment of a receiver. In both cases notices would be filed with the Registrar of Companies. Or, the company could simply 'close its doors'. In any of the above ways, the persons dealing with or likely to deal with the company have received notice of the cancellation of the authority. It is submitted that automatic crystallisation is contrary to the good sense which permeates these agency rules.

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8. S.102(12) provides that filing of the debenture with the Registrar of Companies, shall be deemed notice of the existence of the debenture.

3. AFTER ACQUIRED PROPERTY

The final section of this paper looks at the position of the debenture-holder between the time of the automatic crystallisation and the appointment of a receiver. For the purposes of this paper, notwithstanding the conclusion reached in the second part of the paper, it will be assumed that automatic crystallisation clauses are effective.

The writer submits that there is a distinction between property acquired after a receiver is appointed and property acquired after crystallisation, but before the appointment of the receiver. From the earlier discussion of the nature of the floating charge, it is quite apparent that the essential element of the charge is that it enables the company to carry on its business and deal with its assets 'as if the charge did not exist'.[8] If crystallisation of the debenture is achieved by one of those 'automatic clauses', then it is submitted that the effect must be to cancel the company's right to so deal. The result is that the charge fixed.

At this point it is suggested that the effectiveness of a 'crystallisation' will depend upon whether or not a receiver is appointed. If the receiver is appointed, then under the usual powers of the receiver contained in the deed, the receiver will be the agent of the company and is empowered to carry on the business. This power to carry on the business must of necessity include the power to sell property the subject of fixed charge and acquire new property. It is submitted that such a power would be construed in equity to be an agreement to charge the future acquired assets acquired in the course of carrying on the company's business.[9]

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8. Biggerstaff's case supra., National Provincial Bank of England case supra.

9. See Holroyd v. Marshall (1862) 10 H.L.C. 191 and Tailby v. Official Receiver (1888)

If this is incorrect, then the clause found in most deeds which provides that all moneys received by the receiver shall be applied firstly in payment of all moneys payable in respect of the undertaking and property hereby charged..., would achieve the same result: viz. the debenture-holder obtains priority. This was the position in Wellington Woollen Manufacturing Co. Ltd. v. Patrick[10] where a supplier of goods after the appointment of the receiver claimed payment from the receiver for the purchase price in priority to the debenture-holder. Ostler J. held that where a receiver is appointed to carry on the business, a first charge on the proceeds of so doing will be to pay the purchase moneys for the goods in order that the business can continue to be carried on. The balance of the moneys being payable to the charge-holder. Furthermore, where the receiver has been appointed to carry on the business it is clearly part of the contract that all the subsequent property of the company which is purchased in order to carry on the business of the company becomes subject to the fixed charge the moment it becomes the property of the company.

It is submitted that this is somewhat different from the position of a crystallised charge where no receiver has been appointed. In this latter situation, as a result of the nature of crystallisation, the power to carry on business ceases. Accordingly, unless a receiver is appointed with such power, any further carrying on of the business of the company will be a dealing with assets subject to a fixed charge. If one attempts to argue that after crystallisation the company has the power to deal with the assets the subject of the charge, and that the charge will shift on to the newly acquired assets, then it is submitted that the debenture has not in fact crystallised at all. In other words, those who argue that crystallisation can happen automatically, in that upon the happening of an event the company's power to deal with its assets cease, are locked into a situation which can only be described as a dilemna.

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10. [1975] N.Z.L.R. 23

The main disadvantage of the company trading on after the charge has crystallised is that moneys coming into an overdrawn bank account will be acquired by the bank and tracing rights thereover will cease. Furthermore, while the debenture-holder will have a charge over the stock sold during the period since crystallisation, this will not avail against a bona fide purchaser for value of the legal title.[12] As a practical matter, the prospect of exercising an equitable charge in respect of many stock items may daunt even the most litigious debenture-holder.

It is said[13] that Ferrier v. Bottomer[14] and N.W. Robbie & Co. Ltd. v. Witney Warehouse Co. Ltd.[15] resolved this problem of property acquired by the debtor company after crystallisation of its charge. It is respectfully submitted that such a suggestion misses the point of the issue. The question to be addressed is what is the effect on property acquired by the debtor company after a breach by that company of a kind that is defined as bringing about an automatic crystallisation? It is submitted there are four answers and each will depend upon the facts of the case.

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12. In New Zealand as regards chattels (including book debts) notice of the existence of the charge and its terms will be deemed pursuant to s.102 (12) of the Companies Act 1955 and s.4 of the Chattels Transfer Act 1924. However, these provisions will not deem notice of crystallisation unless notice of the event causing crystallisation can be established. This position though is peculiar to New Zealand and the same notice provisions do not appear in either Australia or the United Kingdom.

13. D.Millman "The Floating Charge and After-Acquired Assets" (1979)The Conveyancer 138, 145.

14. (1972) 126 C.L.R. 597.

15. [1963] 3 All E.R. 613.

First, if a receiver is appointed and that receiver has the power to carry on business, then subsequently acquired assets will be charged in the hands of the receiver.[16]

Secondly, if a receiver is appointed and the debenture deed provides that the charge shall be over all assets of the company, both present and future, then again subsequently acquired assets will be subject to the fixed charge debenture.[17]

Thirdly, where no receiver is appointed and a charge crystallises, then providing future property is included within the charge provisions, it will again be subject to the fixed charge.[18]

And fourthly, where there is an automatic crystallising clause and an event defined in that clause has transpired, then if the company is permitted by the charge holder to continue to deal with the assets of the company, it is submitted the charge, by its very nature, has not fixed and remains floating. The crystallising clause can be one which provides that the company shall cease to have authority to deal with its goods on the

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16. Supra.

17. See Re Strand Music Hall Coy. 3D.J.& S 147 which established the rule in equity that where parties to a contract intended to give a charge, then equity will give effect to that intention notwithstanding any mistake or legal invalidity in the parties' attempt to do so. Then Holroyd v. Marshall]0 H.L.C. 191 where a mortgage of present and future chattels was held binding in equity on the future chattels as they came into the company's possession.

18. See supra., for reference to the difficulties arising from moneys received into an overdrawn bank account or enforcing an equitable charge over stock or assets alienated before the appointment of a receiver.

happening of certain events, or, it may provide the charge shall become fixed on the happening of certain stated events. In this case it is submitted that the charge holder is again subject to the creditors, purchasers, mortgagees, etc. of the company in the same way as if the crystallising event had not occurred.

Hence the danger of the automatic crystallisation clause is not that it will be ineffective with respect to future acquired assets, but that if the company is permitted to carry on its business by the debenture-holder, then as a result of this permission and from the very nature of the floating charge, the charge will not have crystallised and the debenture-holder is left in the same position

"as if the debentures did not exist".[19]

In Ferrier v. Bottomer[20] the High Court of Australia had to determine whether moneys received by the company, after a receiver had been appointed, were subject to the charge. At the date of crystallisation, the debts which gave rise to the receipt of these moneys, were not in Queensland, and therefore not within the description of the property subject to the charge. However, the charge included all "present and future property", and the High Court held that the receiver was entitled, under the terms of the charge to all future property and accordingly he was entitled to these moneys.

It is submitted this case falls squarely within the second of the above rules. Furthermore, it is clear that the case provides no authority, and in fact does not discuss the issues involved where no receiver is appointed.

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19. Biggerstaff's case, ibid., 101.

20. supra.

In N.W. Robbie & Co. Ltd. v. Witney Warehouse Co. Ltd.[21] the Court of Appeal had to decide whether certain debts which became owing to the debtor company after the receiver had been appointed were subject to the now fixed charge of the debenture-holder. From the above rules it is submitted that the receiver would be entitled to a first fixed charge over these book debts[22] either because the receiver had the right to carry on the business of the company and the proceeds therefrom were specifically stated to be used first in reduction of the debt of the debenture-holder, or, because the charge was said to include all future assets of the company. The majority of the Court of Appeal held that the receiver was entitled to a fixed charge over the book debts for both the above reasons.

It is again submitted that the facts of the case preclude any authoritative statements on the position which may have pertained had there been an 'automatic crystallisation' and these particular book debts arose thereafter but prior to the appointment of a receiver.

The argument of the defendants in Robbie's case was that after crystallisation the debenture became fixed and hence subsequently acquired property will not be subject to this fixed charge. Sellers L.J. adopted the reasons of Russell L.J. and rejected the argument of the defendants.

Russell L.J. in rejecting the defendants' argument referred to clause 3 of the deed which extended the charge to all present and future property. The issue of whether the charge was fixed or floating did not affect the field of assets

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21. [1963] 1 W.L.R. 1324.

22. This first fixed charge would amount in equity to an assignment of the chose in action by the debtor company to the debenture-holder.

which were subject to the charge, regardless of the state of the charge at the time of acquisition of the asset. His Lordship says[23] the time of crystallisation only affects the effectiveness of that charge and not whether an asset is subject to the charge. In this case the receiver had been appointed and the charge properly crystallised to render the subsequently acquired assets subject to the charge, now in its fixed state.

The dissenting judgment of Donovan L.J. turned on the question of mutuality and rights of set-off which are not relevant to this paper. However, both Donovan and Russell L.JJ. refer to Biggerstaff v. Rowatt's Wharf Ltd.[24] for authority that after crystallisation of the floating charge the rights of set-off change from the position existing before crystallisation. It is submitted that Biggerstaff is support for the thesis of this paper, that between an automatically crystallising event and the appointment of a receiver the position of creditors and others dealing with the company may not have changed from that existing prior to crystallisation. It will be recalled from the earlier discussion of Biggerstaff's case that there was in that case an automatic crystallising clause, and although the required event had occurred, the Court of Appeal held that notwithstanding the automatic cyrstallisation clause the charge floated until the appointment of the receiver and the debts, the subject of the claim for set-off, although incurred after the automatic crystallising event, were before the appointment of the receiver, and thus set-off was permissible.

By way of conclusion therefore, it can be said that the occurrence of an event specified as crystallising a floating charge debenture will not prevent after-acquired property being subject to the debenture provided the deed contains the usual

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23. ibid., 1382.

24. [1896] 2 Ch.93.

clause extending the charge to present and future property of the company. However, if the charge holder permits the company to continue to deal with its assets, then the charge has in fact not crystallised and although the charge will extend to cover after-acquired assets, the security of the charge holder remains subject to the limitations of a floating charge.

It is submitted that this conclusion arises for any or all of the following reasons:

(a) from the very nature of the charge discussed in the first part of this paper:[25]

(b) from all considerations of policy:[26]

(c) from analysis of the floating charge in the light of agency principles:[27]

(d) from a consideration of the position between the occurring of the automatic crystallising event and the appointment of a receiver, as being a variation of the contract between the debenture-holder and the company:[28]

(e) from a consideration of the issues in terms of the debenture-holder being estopped from relying on an earlier crystallising event when he has allowed the company to continue to hold out to the world that the charge is floating, but allowing the company to continue to deal with its assets.[29]

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25. See especially pages 7, 9.
26. See especially pages 6, 10, 39, 40.
27. See especially pages 40, 41.
28. See especially page 28.
29. The problem arising from both (d) and (e) would be that before such defences could be raised, one would have thought the debenture-holder would have to have had actual knowledge that the crystallising event had occurred.