ALTERNATIVE TYPES OF CHARGE OVER COMPANY BUSINESSES AND THE EFFECT OF WINDING UP ON THEM - RECENT DEVELOPMENTS IN AUSTRALIA AND NEW ZEALAND.

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I. INTRODUCTION

Lately, much of the case law on company charges has concerned attempts to obtain security over the trading assets of companies. In particular, the courts have had to consider attempts to obtain security over the circulating assets of incorporated businesses, otherwise than by way of floating charge. This paper considers these recent cases and some 19th century predecessors, as well as recent developments in the floating charge itself.

II. THE FIXED CHARGE OVER LAND AND THE LICENCE TO SEIZE ASSETS AS ALTERNATIVES TO THE FLOATING CHARGE

One of the most interesting developments, though so far largely unnoticed, has been the decision of Needham J. in *Mercantile Credits Ltd v. Atkins (No. 1)*[1], subsequently affirmed on appeal by the New South Wales Court of Appeal in *Atkins v. Mercantile Credits Ltd.*[2] In brief, this case is authority that a mortgage or charge over land which contains a power, upon default, in the mortgagee to appoint a receiver and manager to enter and run the business which was being carried on, on the land does not create a floating charge over either the land or the assets of the business. The charge in question was found to be a fixed mortgage over the land accompanied by a mere power (vested in the chargor and its

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1 (1985) 9 ACLR 757.
2 (1986) 10 ACLR 153.

appointee as receiver and manager) to deal with the assets of the business which created no proprietary interest in those assets, not even of the limited type of proprietary interest given by a floating charge. It would seem that the mere power to deal would permit the receiver to sell the assets as part of the business being carried on, though not independently to realize the assets *in specie*.

If the case is rightly decided (the writer believes that it can be supported), the mortgage of land with a power to carry on the business does offer secured creditors an alternative to, though not a complete substitute for, the floating charge. The advantages over the floating charge are mostly the same as those for fixed charges generally, to be discussed in the next section of the paper. In particular, charges over land are not registrable under Division 9 of the Companies Code ("the Code")[3], and a fixed charge over land would not be subject to the statutory debt priorities to which the floating charge is subject.[4] However, a charge over land which confers no proprietary interest over the assets of the business is likely, before a receiver is put into possession, to leave the chargee more prone to adverse claimants to those assets than even a floating charge would do.[5] Further, although it was also decided in *Mercantile Credits* that the chargee's power to take possession of the business is not affected by the winding up of the company and the appointment of a liquidator, some concerns as to the application of various statutory provisions on a winding up remain. These are discussed in Part V, section D below.

What then is the pedigree of this case? The answer is, 'fairly murky'. A fair amount of older case law can be found to support the case, albeit not quite in the terms on which Needham J. based his decision. The unfortunate facet of the older case law is that there appears to be no discussion of the relationship of the mortgage over land and business to the floating charge *(Mercantile Credits* seems to be the first case to consider the point). Dr. Gough, in a footnote in *Company Charges*, merely

3 Section 200 of the Code. In New Zealand, charges over land, though included in the s.102 list of registrable charges are, pursuant to s.103(1), not subject to the avoidance provision in s.103(2). This is so irrespective of whether the charge is in fact registered in the Land Transfer Office – see *Re Universal Management Ltd (in liq.)* [1983] NZLR 463, and *Re Mountain View Property Holdings Ltd* [1972] NZLR 1.

4 Principally, the priority given to the company's employees (see ss441-446 of the Code and, in New Zealand, ss101 and 308 of the Companies Act 1955), and income tax priorities (see, principally, s.221P of the Income Tax Assessment Act 1936 (Cth), and in New Zealand, ss327 and 365 of the Income Tax Act 1976. In respect of goods and service tax in New Zealand, see s.45 of the Goods and Service Tax Act 1985). For other statutory priorities affecting floating charges in New Zealand, see R.F.Pethig and I.R.Millard, *Morison's Company Law* (4th ed., 1976), Vol 2, para. 24.28 (hereafter "Morison").

5 Quaere, despite the absence of a proprietary interest in the assets, what might be the legal efficacy in the land charge document (particularly if the document were registered) of a negative pledge by the chargor not to create charges over the assets of the business – as to negative pledges generally, see J.H.Farrar, "Negative Pledges, Debt Defeasance and Subordination of Debt', in J.H.Farrar (ed), *Contemporary Issues in Company Law* (1987), 135.

refers to the jurisdiction of the court to appoint a receiver and manager where the business has been included in the mortgage of land (citing some of these old cases), as forming "an analogous context" to the floating charge[6]. There is not much case law after the turn of the century. This is presumably because, with the incorporation of businesses, large and small, becoming the norm, the floating charge absorbed the attention of practitioners and the courts, just as it did in respect of the fixed charge over future assets of the *Holroyd v. Marshall*[7] type.

The most significant difference between the reasoning in *Mercantile Credits* and those cases on which Needham J. relied[8] is that Needham J. held (and the Court of Appeal agreed) that the power to run the business gave no proprietary interest in the assets of the business, and hence could not be a floating charge which does confer such a proprietary interest, albeit of a limited type.[9] Whereas, in three of the cases his Honour relied on, the mortgage of land seems to have been treated as giving some proprietary interest in the assets of the business, even if not in the individual assets, separate from the business. In the fourth of the cases relied on, *Cook v. Thomas,* there are not enough facts given in the law report to be helpful on this point. In *Chaplin v. Young* the mortgage was over "the contract of *The Sun* newspaper, and of the copyright and goodwill thereof", together with its printing machine, presses, type, fixtures, and stock-in-trade. A receiver and manager was appointed. In *County of Gloucester Bank v. Rudry Merthyr Steam & Coal Co* the mortgage was of all of a colliery's land, mines, seams of coal, buildings, and fixtures. Lord Halsbury and Smith L.J. held that the security interest extended to the business, while Lindley L.J. was less certain.[10] In *Gay v. Johnston* the mortgage of land did not expressly extend to the hotel business carried on there, but Maughan A.J. clearly held that the business "passed" with the mortgage of the land. Likewise, in another leading case, not cited in *Mercantile Credits, Whitley v. Challis*[11], it was held that the mortgage of land in that case did not impliedly cover the hotel business carried on upon it, and hence the mortgagee could not have a receiver and manager appointed to run the business. Lindley L.J. said that the words of the mortgage did not "have the effect of bringing in property which the mortgagor had not agreed to mortgage".[12] Bowen L.J. in the same case stated that:

6 See W.J.Gough, *Company Charges* (1978), 83.
7 (1862) 10 HL Cas 191.
8 Namely, *County of Gloucester Bank v. Rudry Merthyr Steam & House Coal Colliery Co.* [1895] 1 Ch 629; *Cook v. Thomas* (1876) 24 WR 427; *Chaplin v. Young* (1864) 33 Beav 330, 55 ER 395 (and see, at first instance, (1862) 6 LT 97); and *Gay v. Johnston* (1937) 37 SR (NSW) 454.
9 See the discussion on the nature of the floating charge in section C *infra.*
10 See [1895] 1 Ch 629, 638.
11 [1892] 1 Ch 64 (CA).
12 [1892] 1 Ch 64, 69.

> But if the business and goodwill of the hotel are excluded from the mortgage, then on what ground can it be said that the Court has jurisdiction to appoint a manager to manage a business which does not belong to the mortgagee?[13]

On the other hand, it is suggested that not too much should be made of the references to property interests in these cases. First, it would appear that the cases were more concerned with whether the words of the mortgage document covered the business than with whether, in covering the business, the mortgage granted by the document extended a proprietary interest to the assets of the business. Secondly, it is clear from many other cases that, in a mortgage of land, a mere extension to the *goodwill* of a business, without any reference at all to the assets of the business is sufficient to enable the Court (and presumably the mortgagee at its own behest where the document expressly so provides) to appoint a manager to obtain for the mortgagee the profits derived from carrying on that business.[14] A mortgage of goodwill does not charge the individual assets, because: "The goodwill of the business is nothing more than an advantage attached to the house".[15] This point is best made in *Re Millar*[16], where several mortgages of land were held to extend to the goodwill of the dairy businesses carried on upon the land and to give the mortgagees power to enter and manage the businesses, but that they did not give the mortgagees any charge over the businesses themselves. It may also be that a reference in the mortgage, not to goodwill, but merely to entry on to the land by the mortgagee to obtain the "rents and profits" is sufficient to enable the Court to appoint a manager to carry on the business.[17]

Other sources support the concept of the mortgage of land with power in the mortgagee, upon default, to carry on the business. First, the case *Burns Philp Trustee Company Ltd v. Ironside Investments Pty Ltd*[18], which was decided shortly before *Mercantile Credits*, but which was not cited in it, is indistinguishable from it on this point. In *Burns Philp*, a mortgage of land made no reference to mortgaging the hotel business which was being carried on on the land, but contained a clause giving every receiver and manager appointed by the mortgagee, power to carry on and manage any business which may be or have been carried on at or from the land, with power to receive and pay debts. The validity of this power was upheld on a declaration sought by the mortgagee for that purpose.

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13 [1892] 1 Ch 64, 71.

14 *Chissum v. Dewes* (1828) 5 Russ 29, 38 ER 938; *Ex parte Punnett* (1880) 16 Ch D 226; *Cooper v. Metropolitan Board of Works* (1883) 25 Ch D 472; *Truman & Co v. Redgrave* (1881) 18 Ch D 547; *Whitley v. Challis* [1892] 1 Ch 64, 69, 72; *Leney & Sons Ltd v. Callingham and Thompson* [1908] 1 KB 79; *Palmer v. Barclays Bank Ltd* (1971) 23 P & CR 30.

15 *Chissum v. Dewes* (1828) 5 Russ 29, 30; *Palmer v. Barclays Bank Ltd* (1971) 23 P & CR 30.

16 (1952) 16 Australian Bankruptcy Cases 49.

17 *Bompas v. King* (1886) 33 Ch D 279. Contrast *Cadogan v. Lyric Theatre Ltd* [1894] 3 Ch 358.

18 [1984] 2 Qd R 16.

The second additional source of support for *Mercantile Credits* is another long line of older cases. These cases establish that a mere power to seize assets upon default is effective against the grantor's assignee in bankruptcy. The cases originated at common law, as a concession to mitigate the long-established common law rule that the law did not recognize agreements to pass a property interest in assets unless the grantor owned the assets at the time of the agreement.[19] This concession of the common law enabled a lender, for instance, to take a legal mortgage over the borrower's existing assets and couple the mortgage with a power or licence to enter and seize assets to be acquired in the future.[20] As the concept of the licence to seize matured, it became clear that the licence did not confer on grantees any proprietary interest in the assets affected by it[21], but, nonetheless, could be exercised despite bankruptcy[22] (and presumably, winding up in the case of a company – the possible application in a winding up of section 368 of the code (avoidance of dispositions after winding up) and section 454 of the code (disclaimer of onerous property) are discussed below[23]), and enabled grantees to pass good title to third parties, regardless of the grantees' own lack of a property interest.[24]

These cases on the power or licence to seize assets which does not confer a proprietary interest in them clearly provide support for the validity of a power in a mortgagee of land to carry on the business on the land. Nonetheless, the two powers are not the same. For instance, it is considered that a mere power to carry on the business of the mortgagor would not, unlike a power to enter and seize individual assets, enable the mortgagee to sell chattels of the mortgagor otherwise than in the course of carrying on the business, merely as a means of realization.

It should be possible for a mortgage to contain powers both to carry on a business, and to seize and sell uncharged assets. However, it is pointed out that in some jurisdictions the application of the bills of sale legislation to the licence to seize assets should be considered. Because the relevant

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19 *Grantham v. Hawley* (1616) Hobart 132. See further R.R. Pennington, "Fixed Charges over Future Assets of a Company" (1986) 6 *Co Law* 9; Gough, note 6 *supra*, 18-19; D.W.McLauchlan, "Securities over Future Goods" (1973-1975) 7 *VUWLR* 122.

20 See *Hope v. Hayley* (1856) 5E & B 830; 119 ER 690, and the other cases cited in R.R.Pennington, note 19 *supra*, 10-13, and Gough, note 6 *supra*, 44-46.

21 *Reeve v. Whitmore* (1863) 33 LJ Ch 63, 66; *Ashcroft v. Troy* (1873) 1 NZ Jur 61; *Matson v. Craig* (1877) NZ Jur (NS) (SC) 33; *Thompson v. Cohen* (1872) LR 7 QB 527; *Re Lind* [1915] 2 Ch 345.

22 *Belding v. Read* (1865) 3 H & C 955; 159 ER 812, unaffected on this point by the decision in *Tailby v. Official Receiver* (1888) 13 AC 523. See also *Alley v. Hotson* (1815) 4 Camp 325; 171 ER 104. However, the power ceases upon discharge from bankruptcy – see *Thompson v. Cohen* (1872) LR 7 QB 527.

23 The comparable New Zealand provisions are, respectively, s.222 and s.312 of the Companies Act 1955.

24 *Thompson v. Cohen* (1872) LR 7 QB 527.

legislation differs markedly amongst the Australian states[25] and territories and New Zealand, it is not proposed here to give an exhaustive account. It is thought that in most cases registration of a licence to seize given by a company will not, in practice, be needed, even though the relevant definition of bill of sale or instrument in each jurisdiction extends to licences to seize chattels.[26] This view may be true for one or more of the following reasons:

(i) The relevant bills of sale legislation may not apply at all to companies[27];

(ii) In some jurisdictions the only relevant sanction for non-registration provides for avoidance against the assignee in bankruptcy, which office does not include the liquidator of a company[28](an unregistered licence to seize would not be valid against the other classes of protected persons because of the inherently limited nature of the licence[29]);

(iii) In most jurisdictions the failure to register the licence would not preclude the de facto seizure of the assets by the grantee of the power *before* the winding up or bankruptcy of the grantor[30];

(iv) In most jurisdictions the bills of sale legislation does not apply relevantly to licences to seize *future chattels.*[31]

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25 Victoria would seem now to be free of any need to register since the coming into force in 1984 of the Chattel Securities Act 1981.

26 For decisions holding so, see *Re Townsend; ex parte Parsons* (1886) 16 QBD 532, 542; *Climpson v. Coles* (1889) 23 Ch D 465; *Fink v. Fink* (1946) 74 CLR 127; *Kent v. Parer* [1922] VLR 413; *King v. Greig* [1931] VLR 428. See also *Re Vital Learning Aids Pty Ltd* [1979] 2 NSWLR 442.

27 This point is unsettled in most jurisdictions. In *Palette Shoes Pty Ltd v. Krohn* (1937) 58 CLR 1, 23-25, Dixon J. thought that the legislation did apply to company bills of sale other than mortgages and charges, not approving a number of earlier decisions to the contrary. See however, in England, *NV Slavenburg's Bank v. Intercontinental Natural Resources Ltd* [1980] 1 All ER 955. In New Zealand, the Chattels Transfer Act 1924 clearly does apply to bills of sale, other than mortgages and charges, granted by companies - see *Carncross v. Wilson's Motor Supplies Ltd (in liq.)* [1924] NZLR 513, and the definition of grantor in s.2 of the Chattels Transfer Act 1924.

28 *Re Marine Mansions Co* (1867) LR 4 Eq 601; *Re Asphaltic Wood Pavement Co. Ltd* (1883) 49 LR 159. This would appear to be true everywhere (including New Zealand) other than Tasmania, Queensland and the Northern Territory - see E.I.Sykes, *The Law of Securities* (4th ed., 1986), 737-744.

29 This is particularly so in relation to execution creditors, though in relation to people claiming a charge in relation to the assets, quaere the effect of a negative pledge in the licence document. It may be that as between two licensees priority is accorded to the first licence to be given - see *Reeve v. Whitmore* (1863) 33 LJ Ch 63, 66.

30 *Peake v. Hogg* (1885) 4 NZLR (SC) 190; *Johns v. Mulinder* (1916) 35 NZLR 422, and see the cases discussed in Sykes, note 28 *supra*, 741-742. Compare the position under s.103 of the Companies Act 1955 - *Mercantile Bank of India v. Chartered Bank of India, Australia and China and Strauss & Co. Ltd* [1937] 1 All ER 231. Contrast *Royal Bank of Canada v. First Pioneer Investments Ltd* (1985) 12 DLR (4th) 1 (Supreme Court of Canada). Again, the position may not be the same in Queensland, Tasmania and the Northern Territory - see Sykes note 28 *supra*, 557-562.

31 See Sykes, note 28 *supra*, 566-571. The position is otherwise in Queensland (see Sykes, *id*, 569-571) and New Zealand (see s.24 of the Chattels Transfer Act 1924).

Despite all of the above, in *Re Trendent Industries Pty Ltd*[32], Needham J. held that because a mere power to seize was a bill of sale, which if given by an individual would need to be registered under the relevant bills of sale legislation, it was a registrable charge within the then provisions of the relevant Companies Act in New South Wales.[33] It is respectfully submitted that this holding was quite wrong. In order to fall within the regimes for registration found in the then and now current companies legislation (section 200 of the Code) it is a *charge* which must be created by the instrument, something which a power to seize and sell clearly is not.[34]

In contrast to the mere licence to seize, the power to carry on the business coupled with a mortgage of land (which would permit the grantee incidentally to sell the chattels which are used in the business) would not, it is suggested, be within the relevant bills of sale legislation, because the power is inseparably incidental to the mortgage of land.[35]

One can conclude that, subject to the reservations about the application of certain provisions in a winding up, discussed in Part V, section D below, the mortgage of land with a power to carry on the mortgagor's business may be an attractive alternative to some lenders. This will especially be the case where the lender is confident that it can limit the borrower's capacity to grant other charges (by restrictive clause or otherwise). The power to carry on the business might usefully be coupled with a licence to seize and sell individual assets.

III. THE FIXED CHARGE OVER CIRCULATING ASSETS AND BOOK DEBTS

No other aspect of company charge law is currently causing more intense judicial and academic consideration than the fixed charge over circulating assets. The controversy is about whether it is possible to have a fixed charge over future assets forming part of the chargor's stock-in-trade or circulating capital. Those who deny the possibility argue that only the floating charge is available to charge such assets. The issue is common to Australia, New Zealand, the United Kingdom, Ireland and some of the Canadian provinces.

Behind the controversy lie long-standing policy issues, which most of the courts have been reluctant openly to discuss. But only policy matters can explain why courts of the 1860's to the 1880's were apparently largely undisturbed by the fixed charge over stock-in-trade, while more modern courts tend to be reluctant to accept them. It is unfortunate that in the

32 (1983) 8 ACLR 115.

33 Still applicable in New Zealand – see s.102(2)(c) of the Companies Act 1955.

34 See *Thompson v. Cohen* (1872) LR 7 QB 527, 533, and the other cases cited at notes 21, 26 *supra*.

35 Cf.*Re Yates* (1888) 38 Ch D 112; *Climpson v. Coles* (1889) 23 Ch D 465; *OA of* Adams v. Drysdale [1924] NZLR 321. Cf. *Re Penning* (1989) 89 ALR 417.

recent cases the older cases have not been cited to the courts, if only to force them to explain why policy matters would preclude them from following the precedents. It is suggested that it is statute law which has been the principal cause of the change. In particular, there are three types of statutory provision:

(i) Most importantly, those which confer priorities on tax and employee remuneration.[36] These priorities are conferred expressly over floating charges only. Obviously, these provisions are potentially undermined by fixed charges over all of a company's assets;

(ii) Registration provisions, which have the effect of giving the world constructive notice of registered charges.[37] Although cases recognizing the validity of automatic crystallisation clauses and restrictive clauses[38] have meant that third parties can now be adversely affected by floating charges, a registered fixed charge may still obtain some advantages in respect of priorities over adverse claimants which the floating charge cannot. This conferral on fixed charges of the benefit of constructive knowledge to all the world, which such charges would not have had in Victorian times, is a serious fault of some registration regimes which is likely to lead courts to construe fixed charges over large classes of future assets to be floating rather than fixed.

One example of a benefit which constructive notice by registration can give to the holder of a fixed charge which is not available to the holder of a floating charge relates to the ability of outside parties to raise set-offs. It is suggested, contrary to Professor Goode[39], that upon registration of a fixed charge covering a company's book debts, no common law set-offs arising subsequent to the charge can be raised against the chargee by the debtor, at least if it is not possible to construe the charge as giving the chargor a licence to permit such set-offs. This would result from the application of the general rule that once a debtor has actual or constructive notice[40] of an assignment of the proprietary interest in a debt, no set-off can be raised against the transferee.[41] No authority to the contrary is cited by Professor Goode, and since it is well-established that a common law set-off can operate against a floating charge only if the cross-debt

36 See note 4 *supra.*

37 See s.68C(2) of the Code, and in New Zealand, s.102(12) of the Companies Act 1955, and s.4(2) of the Chattels Transfer Act 1924. See also the general discussion of constructive notice by registration of a charge in Gough, note 6 *supra,* chapter 25.

38 And see s.204(3) of the Code. As to such clauses generally, see H.A.J.Ford, *Principles of Company Law* (4th ed., 1986), 264-266, 276-278; J.H.Farrar and M.Russell, *Company Law and Securities Regulation in New Zealand* (1985), 168-173; *Morison,* note 4 *supra,* paras 24.24 and 24.32.

39 R.M.Goode, "The Effect of a Fixed Charge on a Debt" [1984] *JBL* 172.

40 See *Siebe Gorman & Co Ltd v. Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142. In New Zealand, see s.4(2) of the Chattels Transfer Act 1924.

41 See *Halsbury's Laws of England* (4th ed., 1974), Vol 6, "Choses in Action", para. 64.

arose before[42], but not after, notice of crystallization[43], when a floating charge merely becomes a fixed charge, the position must be *a fortiori* a charge which is fixed all along.

The only authority of which the writer knows that supports Professor Goode on this set-off point is an obiter dictum of McCarthy J. in *Re Keenan Bros Ltd*[44], a dictum made almost as an aside, again without citation of precedent. Professor Goode's view that fixed charges are subject to set-offs arising after, as well as before, the creation of the charge is based on drawing a distinction between an assignment of a debt and a charge of it. The failure by texts and judges to make this distinction is castigated by him. He even suggests that a fixed charge confers no proprietary interest on a chargee. This writer deprecates the attempt to suggest that a charge of a chose in action is not a form, albeit limited, of assignment.[45] In any event, it is predicted that if a charge is not treated as a form of assignment, practitioners will merely create equitable mortgages instead of charges over book debts. The distinction suggested by Professor Goode would only complicate equity, which has become used to speaking of "absolute assignments" and "assignments by way of charge". In any event, it is clear that even were one to make the distinction it is far too late for it to be of any significance in relation to set-off.[46] Returning to the central point, because a debtor who has a set-off would need to have notice of crystallization of a floating charge[47], and because there has not yet been judicial approval of a restrictive clause in a floating charge which attempts to preclude outsiders from asserting a right of

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42 *Biggerstaff v. Rowatt's Wharf Ltd* [1896] 2 Ch 93.

43 See *N W Robbie & Co Ltd v. Witney Warehouse Co Ltd* [1963] 1 WLR 1324; [1963] 3 All ER 613; *Rendell v. Doors and Doors Ltd* [1975] 2 NZLR 191, 200, citing *Kerr on Receivers*, which expressly states that the position is the same for fixed charges; *Business Computers Ltd v. Anglo-African Leasing Ltd* [1977] 1 WLR 578; [1977] 2 All ER 578; and the other cases found in *Morison*, note 4 *supra*, para. 24.27.

44 [1986] BCLC 242, 251 (Supreme Court of Ireland).

45 The writer supports the view of Dr Gough in note 6 *supra*, 216-217, that a charge subtracts from the chargor's ownership right to alienate, and therefore is a form of assignment of an ownership interest. Contrary views are set out by Dr Gough, *ibid* (See also *DCT v. Lai Corporation Pty Ltd* [1987] WAR 15, also reported as *Norgard v. DFC of T* (1987) 5 ACLC 527, and *Re Charge Card Services Ltd* [1987] Ch 150, affirmed [1988] 3 WLR 723 (CA) where nothing turned on the point) and D.W.McLauchlan, "The Concept of the 'Charge' in the Law of Chattel Securities" (1975) 8 *VUWLR* 283, 289.

46 It is curious that Goode's view, note 39 *supra*, is inconsistent with the more extended treatment of set-off in his own *Legal Problems of Credit and Security* (2nd ed., 1988). At pages 89-90 of that book, he states: "Once a floating charge crystallizes, so as to become fixed, the general rule is that it has priority over subsequent interests, including set-offs, in just the same way as if it had been fixed at the outset."

47 See Goode, note 46 *supra*, 45; *Lazarus v. Andrade* (1880) 5 CPD 318; *Taylor v. McKeand* (1880) 5 CPD 358; *Payne v. Fern* (1881) 6 QBD 621; *Clement v. Matthews* (1883) 11 QBD 808 (CA); *Joseph v. Lyons* (1884) 15 QBD 280 (CA); *Hallas v. Robinson* (1884) 15 QBD 288 (CA); *Re Clarke* (1887) 36 Ch D 348 (CA); *Taylor v. Bank of New South Wales* (1886) 11 AC 596 (JCPD); *Tailby v. Official Receiver* (1888) 13 App Cas 523 (HL); *Re Neal* [1914] 2 KB 910.

set-off[48], then, in this respect, the fixed charge would have an advantage over the floating charge. Naturally, should a court accept that it is possible to grant a fixed charge over all of a company's present and future book debts, it is likely that it would strain to imply into the charge document a licence in the chargor to allow set-offs to be raised against the charged debts;

(iii) Lastly, the registration provisions of the Code make registrable all floating charges, whereas not all fixed charges created by a company are registrable.[49] Courts are likely to be reluctant to allow gaps in the statutory registration scheme to be exploited.

These difficulties created by statute did not exist when the early decisions upholding fixed charges over circulating assets were decided. The cases appear in the law reports following the recognition at equity, in *Holroyd v. Marshall*[50], in 1862, of fixed charges over future assets. The cases are too numerous even to list.[51] For example in *Payne v. Fern* a charge over all stock-in-trade was held valid, and conferred priority over a third party who had bought goods off the chargor outside the course of the chargor's business. The Court found that there was an implied licence in the chargor to deal with the charged assets in the course of his business, but the transaction in question was outside that business. A charge over present and future stock-in-trade with an express licence to deal was upheld in *Taylor v. M'Keand*, again defeating an outsider who bought outside the trader's business. The efficacy of the fixed charge over stock-in-trade with a licence to deal was upheld in a series of strong English Court of Appeal decisions in the 1880's including *Hallas v. Robinson*, where the charge was over the chargor's stock-in-trade together with all after-acquired assets to be brought onto stated premises, and his present and future book and other debts. The cases died out after the Bills of Sale

48 See *Brunton v. Electrical Engineering Corporation* [1892] 1 Ch 434. Section 204(3) of the Code deals only with restrictive clauses against other charges. As to the possibility, under the Code, of a restrictive clause affecting parties other than another chargee, see W.J.Gough, *Company Charges - An Australian Supplement* (1983), 45-48.

49 See s.200 of the Code. In New Zealand, see the more restrictive list in s.102 of the 1955 Act. Indeed, in New Zealand, before the Chattels Transfer Amendment Act 1974 permitted individuals to grant security over stock-in-trade, it is likely that a fixed charge over stock-in-trade by a company, if permissible under general law, would not have been registrable. This was because the sole relevant class of registrable charge in s.102 is that which requires only charges which individuals can give and which are registrable under the Chattels Transfer Act 1924, and a charge over future assets could not be given by individuals - see *Carncross v. Wilson's Motor Supplies Ltd* [1924] NZLR 327.

50 (1862) 10 HL Cas 191.

51 The best illustrative cases include *Re Marine Mansions Co.*(1867) LR 6 Eq 601; *Leathem v. Amor* (1878) 47 LJ (QB) 581; *Lazarus v. Andrade* (1880) 5 CPD 318; *Taylor v. M'Keand* (1880) 5 CPD 358; *Payne v. Fern* (1881) 6 QBD 621; *Clement v. Matthews* (1883) 11 QBD 808 (CA); *Joseph v. Lyons* (1884) 15 QBD 280 (CA); *Hallas v. Robinson* (1884) 15 QBD 288 (CA); *Re Clarke* (1887) 36 Ch D 348 (CA); *Taylor v. Bank of New South Wales* (1886) 11 AC 596 (JCPC); *Tailby v. Official Receiver* (1888) 13 AC 523 (HL); *Re Neal* [1914] 2 KB 910.

Act Amendment Act 1882 (UK), section 5 of which made void as against third parties most bills of sale over after-acquired chattels. A number of these cases are discussed by Dr. Gough[52], but are all treated either as instances of floating charges or as anomalous, if not wrongly decided. It is respectfully submitted that these assertions are unconvincing.

It was only when companies tried to charge their undertakings and goodwill, together with other property, that one begins to find the courts expressing concern that to do so is not possible by fixed charge.[53] It is most unfortunate that the courts did not address the relevance of the fixed charge with a licence to deal, approved in the above cases, when they were developing the floating charge. However, the tide clearly turned in 1903 in the celebrated case, *Re Yorkshire Woolcombers Association Ltd.*[54] By this time the English Companies Act 1900 contained a reference to the floating charge, and one of the grounds for decision in the case was that the charge at issue was void for want of registration as a floating charge. The charge did not purport to charge the company's goodwill or undertaking, but only its present and future book and other debts. The courts held the charge to be floating so that it required registration[55] and was, as the later charge, subject to a prior floating charge. Just as the earlier cases on fixed charges did not consider the cases on the floating charge, in this case only *Tailby v. Official Receiver* was cited to the Court, and even that case was not referred to by any of the judges, although Farwell J., at first instance, had adopted the somewhat ambiguous dicta of Lord Macnaghten in *Tailby* that likened the charge in that case to a floating charge. Although this case is considered a leading authority on the nature of the floating charge, it has to be said that both at the Court of Appeal level, and later in the House of Lords[56], cursory treatment of the precedents and principles was given in deciding that the charge was only floating when it was expressed to be fixed.

The subsequent history and the rash of recent cases are dealt with elsewhere.[57] These cases have mostly turned on the application of the

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52 Note 6 *supra*, 130-135. See the criticism of Dr. Gough's views on this matter by D.W.McLauchlan, (1979) 4 *Otago LR* 396. Dr. Gough appears recently to have modified his view of the fixed charge over future assets - see the paper in note 57 *infra*.

53 See *King v. Marshall* (1864) 13 Beav 565; 55 ER 488; *Re New Clydach Sheet and Bar Iron Co* (1868) LR 6 Eq 601; *Re Florence Land and Public Works Co; ex parte Moor* (1878) 10 Ch D 530.

54 [1903] 2 Ch 284.

55 Under s.4 of the Companies Act 1900. That Act did not require fixed charges over book debts to be registered.

56 *Sub nom, Illingworth v. Houldsworth* [1904] AC 355.

57 See R.R. Pennington, "Fixed Charges over Future Assets of a Company" (1985) 6 *Co Law* 9, and [1987] *Butterworth's Banking and Financial Law Review* 177; D.Milman, "Fixed Charges Over Future Assets: Fresh Doubts" (1985) 6 *Co Law* 86; Goode, note 39 *supra*, and *Legal Problems of Credit and Security*, note 46 *supra*, 51-59; M.J.Robbie and C.P.Gill, "Fixed and Floating Charges: A New Look at the Bank's Position" [1981] *JBL* 95; G.McCormack, "Fixed Charges on Future Book Debts" (1987) 8 *Co Law* 3; R.A.Pearce, "Fixed Charges Over Book Debts" [1987] *JBL* 18. Cf. D Everett, *The Nature of Fixed and Floating Charges as Security Devices* (1988).

statutory provisions which confer priorities over floating charges. Usually the courts have not found that there is a fixed charge, even if the document in question has called the charge a fixed charge. Some of the courts have been content to reach this result on the construction of the clause in question[58], which disingenuously defeats the drafter's purpose. Others have been satisfied to state that only a floating charge can have been intended because a fixed charge over the assets in question would result in the paralysis of the company's business, since the lender's consent would need to be obtained for each dealing by the company.[59] But none of these cases gives adequate reasons why consent to dealings with charged assets cannot be given in advance, in the charge document itself, and yet still create a fixed charge.

In these recent cases, the courts have either not discerned or not articulated that the difficulties they are confronted with are caused by the statutory provisions at issue. Instead of forcing the issues to a head which might have assisted in bringing about changes to the legislation, the courts have adapted the common law in an attempt to accommodate the statutes. The same is true of *R. v. Federal Business Development Bank*[60], although that case deserves more extended discussion than most of the other because there is an attempt in the judgments of the divided Court of Appeal of British Columbia to treat the policy issues involved. This decision resulted in a local reversal of approach to the fixed charge, because the Canadian jurisdictions had generally been much more willing to recognize the fixed charge over future assets than other Commonwealth jurisdictions.[61] At issue was a priority contest between a statutory lien for sales tax and a charge given to the defendant bank. The relevant statute accorded the lien priority only over a floating charge. The charge was expressed to be fixed over the relevant company's stock-in-trade. The charge document gave the company express permission to sell the stock-in-trade in the ordinary course of its business, until notified in writing by the bank. The majority of the British Columbia Court of Appeal (McLachlin and Wallace JJ.A.), ruling in favour of the Crown, held that whatever the legitimate extent of the fixed charge might be, it did not extend to a general charge over stock-in-trade which gave in advance to the chargor a general licence to deal. McLachlin J.A. (with whose judgment Wallace J.A. agreed) stated:

> Why did the courts reject the concept of a fixed charge with a license to deal?[62] In doing so, they undeniably limited the freedom of debtor and creditor to contract as they might choose in an age when freedom of contract was paramount. The answer, it

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58 See the cases cited in *Morison*, note 4 *supra*, para. 214.23.

59 See, e.g., *Re Yorkshire Woolcombers* [1903] 2 Ch 284, 296, and *DCT v. Lai Corporation Pty Ltd* [1987] WAR 15.

60 [1988] 1 WWR 1.

61 The case contains a good discussion of the other Canadian decisions.

62 This, of course, assumes that the authorities did reject the general fixed charge; a questionable assumption which the dissenting judgment of Lambers J.A. attempts to rebut.

> may be suggested, lies in the effects which recognition of such a concept would have upon the rights of third parties and general commercial activity, as well as the perceived injustice of allowing the debtor to trade freely while remaining immune from the normal incidents of legal process [p.35]...It would be unfair and inconsistent to permit a debenture holder to grant to a debtor the right to carry on business, while insulating him from the usual incidents of doing business, such as seizure and sale by creditors and liens incidental to the business imposed by statute...[p.38]. Any other conclusion would be contrary to ordinary commercial expectations and detrimental to the public interest...Suppliers of stock-in-trade would lose their rights of garnishment and seizure. It is not sufficient, in my view to tell them that they might materially reduce and constrict business and the flow of wealth and should not be adopted by the courts in the absence of cogent and compelling reasons.[p.39]

The dissent of Lambert J.A. also directly addressed the policy issues. His Honour was not impressed by the supposed adverse impact the recognition of fixed charges over stock-in-trade would have on persons dealing with the company. Suppliers could insist on cash on delivery. Buyers might obtain insurance against the risks of not obtaining title free of charges. Further, if the terms of a charge were too restrictive of the power of the chargor to deal with the assets, the business of the chargor might be frustrated and the market could be expected to correct attempts by chargees to impose unreasonable conditions on the chargor. His Honour was also strongly opposed to the practice of the courts construing fixed charges as floating charges when that was evidently contrary to the wishes of the drafter.

It is respectfully submitted that neither the majority nor the minority positions in this case provides a satisfactory answer to the problems which the fixed/floating charge issue raises. In relation to the majority position which is concerned about the position of unsecured creditors of the company, it is pointed out that those jurisdictions[63] which permit automatic crystallisation of a floating charge have already undermined the position of such creditors, because automatic crystallization can occur to defeat their exercise of judgment remedies.[64] Even in the absence of an automatic crystallization clause, the courts have already given such creditors a 'raw deal', by requiring them to have *completed* the relevant court procedures before crystallization of a floating charge.[65] Secondly, insofar as the majority judgment gives effect to the statutory priority point at issue, it is suggested that these statutory priorities operate somewhat arbitrarily such that the courts ought not to feel compelled to construe contracts of mortgage against the literal wording of them in order to make the statutes apply. In particular, these priorities attack only floating

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63 Which does not include British Columbia it seems. See the cases cited in note 99 *infra*.

64 See the next section of this article.

65 See *Morison*, note 4 *supra*, paras 24.25 and 24.26. The floating charge holder can also apply for the appointment of a receiver on the grounds of jeopardy where unsecured creditors are levying execution against the secured assets - see *Re London Pressed Hinge Co. Ltd* [1905] 1 Ch 576.

charges on the assumption that floating charges are always created over all the assets of the company concerned. In fact, it is long-established that floating charges can be given over only some of a company's assets[66], with the result that the statutorily preferred creditor can pick on a floating charge holder to take priority when there might be other security holders whose securities are of substantially greater value. The statutory priorities should either be removed altogether (particularly the taxation ones)[67] or replaced with a fair regime which affects both fixed and floating charges, and which provides for contribution amongst chargees.

On the other hand, in respect of the dissenting judgment of Lambert J.A., despite the force of that which the learned judge argues, it does seem unrealistic to expect third parties dealing with the chargor (those people constituting his Honour's "market") who may have nothing but constructive knowledge of the contents of overweening charges to correct this greed by refusing to trade with the chargor until the charge is altered. General secured creditors are currently having their cake and eating it – they want suppliers and other traders with the company to deal with the company but at the same time try, when the crunch comes, to deny them the efficacy of the terms on which they have supplied. In these circumstances, the legislature might establish a charge regime which conclusively presumed that which reasonable parties would agree to, rather than leaving it to "the market" to correct excessive possessiveness by some chargees. Thus, the law might provide that set-offs can be raised against the security, and that purchase-money securities[68] take priority over general securities (be they fixed or floating), at least unless prohibitions in the general securities are expressly brought to the actual notice of such creditors. The adoption of a comprehensive regime along the lines of those found in the North American personal property security statutes would achieve these ends – it is likely also gradually to lead to the demise of the floating charge and the widespread use of the fixed charge over stock-in-trade or "inventory".[69] One might then only hope that the

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66 *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284; *Re Bond Worth Ltd* [1980] Ch 228. The latter case shows that the most likely candidates for a floating charge of limited ambit are purported reservation of title clauses which are given effect as floating charges only and charges over choses in action.

67 Cf s.386 of the Insolvency Act 1986 (UK), which reduces the Crown tax priorities to VAT (arising within 6 months of the receivership) and PAYE (arising within 12 months of a receivership). For a discussion of the policy issues involved, see *Report on Insolvency Law and Practice* (Cmnd 8558, 1982 Cork Report, Great Britain), 319-329, and Australian Law Reform Commission, Discussion Paper No 32, *General Insolvency Inquiry* (1987), paras 470-486, and ALRC Report No. 45, 1988.

68 Cf s.34, Personal Property Security Act of Ontario.

69 See J.H.Farrar and M.A.O'Regan, *Reform of Personal Property Security Law: A Report to the New Zealand Law Commission* (1988); New Zealand Law Commission, Report No. 8, *A Personal Property Securities Act for New Zealand* (1989); D.W.McLauchlan, "Contract and Commercial Law Reform in New Zealand" (1984) 11 *NZULR* 36, 50; and R.J.Wood, "The Floating Charge in Canada" (1989) 27 *Alberta LR* 191.

judicial tendency to restrict the fixed charge these last 80 years would not persist.

Meanwhile, the most one can safely assume from the recent cases is that tight control over the use of the assets must be retained by the chargee if a fixed charge is to be upheld. It would certainly now seem that it is not safe to allow the chargor to deal with the assets in the ordinary course of business. This probably makes the fixed charge over stock-in-trade impracticable. As far as fixed charges over book debts are concerned, it appears from *Siebe Gorman & Co Ltd v. Barclays Bank Ltd*[70] that there may be a sufficient degree of control exercised by the chargee if the proceeds of the book debts are required to be kept in an account with the chargee (or otherwise in an account under its control) and no other charges or assignments of the debts are permitted to be given without its consent. In this case, Slade J. did not treat these requirements as necessary, as opposed to sufficient, but in the light of the subsequent cases[71] this would now appear at the least, highly prudent. In another successful recent case the proceeds of the book debts were not only required to be paid into an account with the chargee, but drawings on the account were permitted only on the countersignature of the chargee.[72]

IV. THE FLOATING CHARGE

The floating charge itself continues to be the subject of debate. Two issues of recent interest in relation to the floating charge are the nature of the interest, if any, the floating charge gives the chargee in the company's assets before crystallization, and the events which can cause crystallization.

A. THE NATURE OF THE INTEREST CONFERRED BY THE FLOATING CHARGE

As to the nature of the interest conferred by the floating charge, there are two views[73], both supported to some extent by authority. One view, best found in the writings of Dr. Gough[74], is that no proprietary interest in the particular assets covered by the floating charge is conferred before

70 [1979] 2 Lloyd's Rep 142. See also *Re a Company No. 005009 of1987* (1988) 4 BCC 424; and *Re Permanent Houses (Holdings) Ltd* [1988] BCLC 563.

71 See *DCT v. Lai Corporation Ltd* [1987] WAR 15 (and the four other Australian cases cited in *Morison*, note 4 *supra*, para. 24.23, fn(j), and in the United Kingdom, *Re Armagh Shoes Ltd* [1984] BCLC 405, and *Re Brightlife Ltd* [1987] 2 WLR 197.

72 *Re Keenan Bros Ltd* [1986] BCLC 242.

73 A third view, see G.C.Thorpe, *Floating Charges, Crystallization and After-acquired Property* (1981) turns out to be close to that of Dr. Gough, note 74 *infra.*

74 Note 6 supra, 71-76, 115-137, and Gough, "The Floating Charge: Traditional Themes and New Directions" in P.D.Finn (ed), *Equity and Commercial Relationships* (1987) 239, 252-263.

crystallization. The other view, promoted by Professor Farrar[75], is that a proprietary interest does arise before crystallization, though it is a lesser interest than that conferred by a fixed charge, and is defeasible in the ordinary course of the chargor's business.

The controversy has been said to be one of "academic significance, but practically rather barren".[76] This writer would prefer to say that the controversy is practically quite significant, but theoretically rather barren. What lies behind the dispute is the age old technique of lawyers, of deciding legal questions by the application of question-begging labels. The concept of the floating charge has been particularly marred by this technique. Thus, it is suggested that where a judge feels that in a conflict between the holder of a floating charge and another, that other ought to succeed, or that a statutory provision which applies to a mortgage ought not to be extended, the floating charge is defined in terms of metaphors such as "flotation", "hovering", "ambulation", or "dormancy". Likewise, where the judge has wanted the holder of the floating charge to succeed, or more often to be caught by legislation which itself assumes the existence of legal labels such as "mortgage" or "property interest", the charge is described as giving some sort of proprietary interest in the assets.

The fact of the matter is that it is difficult to answer in advance, by the adoption of a unitary test, who should win any particular question involving a charge over the changing assets of a business. It is for this reason that, if one had to choose between the two theories as to the proprietary interest, this writer would prefer the theory of Professor Farrar, since the other theory, when combined with the metaphors of floatation, does tend to prejudge the difficult question whether a floating charge should win a particular priority contest and whether a floating charge should be caught by a statutory reference to property interests in assets.

As indicated, both theories have a measure of judicial support. It is necessary here to deal only with the more recent cases. Until very recently, the cases were tending to opt for the theory that the floating charge did confer some form of proprietary interest in assets before crystallization. Thus, the limited proprietary interest conferred by the floating charge has been used to explain how dispositions outside the company's course of business are ineffective against the floating charge even before

75 Farrar, "World Economic Stagnation puts the Floating Charge on Trial" (1980) 1 *Co Law* 83, and "Chattel Securities - Revision and Update", New Zealand Law Society Seminar, May 1987. See also E.Ferran, "Floating Charges - the Nature of the Security" [1988] *CLJ* 213.

76 See Thorpe, note 73 *supra*, 4.

crystallization.[77] In *Re Margart Pty Ltd*[78] the existence of a proprietary interest was used to hold that assets subject to a floating charge are not the company's property for the purposes of section 368 of the Code (avoidance of dispositions of company property after commencement of winding up). In *Atkins v. Mercantile Credits Ltd*[79] the New South Wales Court of Appeal used the existing interest given by the floating charge to contrast the lack of a proprietary interest in the assets of the business which is given by the mere power to carry on the business when collateral to the mortgage of land. There are other cases.[80]

In contrast, in *Tricontinental Corporation Ltd v. Federal Commissioner of Taxation*[81], Williams J., after considering the older and more recent cases, rejected the concept of the floating charge conferring any proprietary interest before crystallization. The other two members of the Supreme Court of Queensland (Connolly and Shepherdson JJ.) held that the floating charge gave no interest in particular assets. This holding does not necessarily mean that there is no proprietary interest of any sort given, but the tenor of the judgment is plainly against such a proposition. The case involved a notice of attachment served by the Federal Commissioner of Taxation on two debtors of the taxpayer company, pursuant to section 218 of the Income Tax Assessment Act 1936 (Cth).[82] The holder of the floating charge unsuccessfully claimed priority over the debts by virtue of its floating charge. It is submitted that it was sufficient for the Court to have decided the case on the ground that a floating charge does not confer an equitable interest of the same status as a fixed charge, without deciding that the charge conferred no interest at all in the assets.

An interesting equivocality as to the nature of the floating charge is found in two judgments of Dixon J. in the 1930's. In *Barcelo v. Electrolytic Zinc Company of Australasia Ltd*[83] it was argued that no estate or interest in any item of property covered by the floating charge was conferred on the

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77 *Hamilton v. Hunter* (1982) 7 ACLR 295; *Torzillu Pty Ltd v. Brynac Pty Ltd* (1983) 8 ACLR 52; *Re Barlett Estates Pty Ltd* (1988-1989) 14 ACLR 512; *Fire Nymph Products Ltd v. The Heating Centre Pty Ltd* (1988-1989) ACLR 274; and, less clearly, *Reynolds Bros (Motors) Pty Ltd v. Esanda Ltd* (1983) 8 ACLR 422 – compare Glass J.A., 423 and Mahoney J.A., 426 with Priestley J.A., 431. Cf. *Julius Harper Ltd v. F.W. Hagedorn & Sons Ltd* [1989] 2 NZLR 471. Cases of this type are treated by Dr Gough either as wrongly decided or as better treated as cases of crystallization caused by the company ceasing to carry on its business – see note 70 *supra*, 254-259.

78 (1984) 9 ACLR 269.

79 (1986) 10 ACLR 153.

80 See *DFC of T v. Lai Corporation Pty Ltd* (1986) 4 ACLC 96, aff'd *sub nom Norgard v. DFC of T* (1987) 5 ACLC 527; *Stradbrooke Waters Co-owners Co-operative Society Ltd v. Taylor* (1987) 11 ACLR 85, 91; *Canadian Imperial Bank of Commerce v. W.G. Fahlman Ltd* [1989] Canadian Current Law, para. 5379 (Alberta CA); *First City Corporation v. Downsview Nominees Ltd* (1988) 4 NZCLC 64, 254.

81 (1988) 12 ACLR 421.

82 See s.400 of the Income Tax Act 1976 (NZ).

83 (1932) 48 CLR 391. Cf. *First City Corporation v. Downsview Nominees Ltd* (1988) 4 NZCLC 64, 254.

chargee before crystallization, so that the provisions of financial legislation affecting mortgages and securities were inapplicable. Dixon J. rejected this argument, citing the judgment of Buckley L.J. in *Evans v. Rival Granite Quarries Ltd*[84], where his Lordship refers to the floating charge as being a present security "applying to" every item of the assets of the company, but not "specifically affecting them", itself an ambiguous dictum. In contrast, in *O'Day v. The Commonwealth Bank of Australia Ltd*[85], Dixon J., citing *Governments Stock and Other Securities Investment Co Ltd v. Manila Railway Co*[86], which case stresses the floating nature of the charge, held that the floating charge vested in the chargee no proprietary interest in any of the assets (Starke J. was of like view, and Rich J. concurred with Dixon J.). This reasoning was used to reject an argument of the guarantor in the case, that, by allegedly breaking the terms of the floating charge, the charge holder had wrongfully entered into possession and sold some of the company's assets, thereby making it impossible for the company to be restored to its prior position and accordingly discharging both the loan and the guarantee. There was some authority in favour of this argument in cases involving mortgages of land. Dixon J. distinguished these cases on the basis that the floating charge conferred no property interest in the assets. This, with respect, was odd reasoning since the alleged trespasses must have occurred if at all after the charge had crystallized into a fixed charge.

There is nothing much one can conclude in the face of the controversy, other than to wish for the demise of the floating charge itself, and the resurrection of the fixed charge over all assets coupled with a priority regime along North American lines.

Meanwhile, the other issue concerning the floating charge to receive recent consideration in the cases, is the causes of crystallization. Comprehensive treatments are again to be found elsewhere.[87]

B. THE EFFECT OF CRYSTALLIZATION OF ONE FLOATING CHARGE ON ANOTHER

A difference has developed between the Australian and English case law on the question of whether the crystallization of one floating charge automatically causes another floating charge to crystallize. While not doubting that a floating charge would crystallize upon another floating charge crystallizing or a receiver being appointed under that other charge, if that was expressly provided for, Nourse J. has held, in *Re Woodroffes (Musical Instruments) Ltd*[88] that, in the absence of an express provision,

84 [1910] 2 KB 979.
85 (1933) 50 CLR 200. See now *Re Selvas Pty Ltd* (1989) 52 SASR 449.
86 [1897] AC 81.
87 See Ford, note 38 *supra*, 274-276; Farrar & Russell, note 38 *supra*, 168-171; Goode, note 46 *supra; Morison,* note 4 *supra*, para. 24.32, where other writing is collected.
88 [1985] 2 All ER 908.

the crystallization of a second floating charge does not automatically cause a prior floating charge to crystallize. It is not clear from the judgment what his Honour's view would have been were it the prior floating charge which had crystallized first, rather than the second floating charge. On the other hand, in *DCT v. Lai Corporation Pty Ltd*[89], a majority of the Supreme Court of Western Australia (Burt C.J. and Wallace J.), has held that the crystallization of a prior floating charge by the appointment of receivers causes a second floating charge automatically to crystallize, by operation of law. The judges relied on *Stein v. Saywell.*[90] However, *Stein's Case* was distinguished by Nourse J. in *Woodroffes' Case* on the ground that in that case there was an express provision for automatic crystallization on the appointment of any receiver. Nourse J. was also prepared to decide that even if, as in *Stein,* a receivership under one charge did cause the other to crystallize, a mere notice of crystallization by one chargee, as occurred on the facts of the case, was not sufficient to cause the prior charge to crystallize.[91] Kennedy J. dissented in the *Lai Corporation Case.* His Honour relied on *Woodroffes* and the views of Mr. Picarda in *The Law Relating to Receivers and Managers*[92], and he distinguished an apparently contrary decision of the Saskatchewan Court of Appeal in *Federal Business Development Bank v. Prince Albert Fashion Bin Ltd.*[93] It is respectfully suggested that the view of Nourse J. and the dissenting opinion of Kennedy J. are to be preferred.

C. CESSATION OF BUSINESS AND WINDING UP

Nourse J. also held in *Woodroffes' Case* that cessation of business (but not ceasing to be a going concern, if there be any difference in the two phrases) causes a floating charge to crystallize, thus clearing up a long-standing doubt.[94]

While it is clear that any winding up of a company (voluntary or compulsory, or by members or creditors) causes a floating charge automatically to crystallize, it seems that the appointment of a provisional liquidator only will not cause a floating charge to crystallize.[95]

D. AUTOMATIC CRYSTALLIZATION CLAUSES

It is still not settled as to whether a charge document can add to the judicially recognized events of crystallization, and if so, what are the limitations, if any, on automatic crystallization.

The view that the parties are free to determine their own crystallization

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89 [1987] WAR 15.
90 (1969) 121 CLR 529.
91 [1985] 2 All ER 908, 913.
92 H.Picarda, *The Law Relating to Receivers and Managers* (1984), 21-24.
93 [1983] 3 WWR 464.
94 See also *Re Margart Pty Ltd* (1984) 9 ACLR 269.
95 *Re Obie Pty Ltd* (1983) 8 ACLR 574, aff'd (1985) 9 ACLR 151 (SC of Qld); *Re Rothercroft Pty Ltd* (1986) 4 ACLR 305.

events, expressed in *Re Manurewa Transport Ltd*[96], seems to be the more popular view in the recent cases.[97] Both *Woodroffes' Case* and *Re Brightlife Ltd*[98] provide recent English authority that it is possible for a clause to provide for crystallization upon the giving of a notice to this effect by the chargee to the company chargor. But both cases also approved of automatic crystallization in general, suggesting that statutory intervention would now be needed if it were thought that automatic crystallization was undesirable. In *Brightlife*, Hoffman J. expressly preferred *Re Manurewa* to the leading case which had rejected the concept in British Columbia, *R. v. Consolidated Churchill Copper Corporation Ltd.*[99] These English cases have been the subject of a considered approval by Rogers C.J. in the Commercial Division in *Fire Nymph Products Ltd v. The Heating Centre Pty Ltd.*[100]

On the other hand, in the *Lai Corporation Case*[101], Burt C.J. said of automatic crystallization:

> It is an idea which appears not to have been fully worked out in the cases. By way of illustration, would a breach by the mortgagor of any covenant in the debenture, even if not known to the mortgagee and not acted upon by him so that the mortgagor continues to carry on business nevertheless cause the floating charge to crystallise and to become specific or fixed? That would seem to me an odd result and that the inconvenient consequences of it are evident enough.

Although there are undoubted difficulties with automatic crystallization that have still to be worked out, this writer respectfully agrees with the views of Professor Goode[102] and Dr. Gough[103] that there are few occasions when automatic crystallization will adversely affect outsiders who do not have notice of the crystallization. Admittedly, because execution creditors do not need notice to be affected by a crystallized floating charge, some embarrassment may arise from automatic crystallization, though Professor Goode suggests that, in such circumstances, the charge may be found to have decrystallized by estoppel if no action is taken by the chargee following automatic crystallization.

V. THE EFFECT OF WINDING UP ON COMPANY CHARGES

The general effect of winding up on the realization of charges and on

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96 [1971] NZLR 909.

97 See *DC of T v Horsburgh* [1983] VR 591, aff'd on other grounds in [1974] VR 773, and *Re Obie Pty Ltd (No 2) (1983) 8 ACLR 574, aff'd (1985) 9 ACLR 151.*

98 [1987] 2 WLR 197. *See also Re Permanent Houses (Holdings) Ltd* [1988] BCLC 563.

99 [1978] 5 WLR 652. See also *Re Caroma Enterprises Ltd* (1979) 108 DLR (3D) 412, discussed by D.Milman and D.Hare, "Company Charges: Recent Developments in Canada" (1981) 125 *Sol Jo* 549.

100 (1988-1989) 14 ACLR 274.

101 [1987] WAR 15, 24-25.

102 Note 87 *supra*, 59-77.

103 Gough,"The Floating Charge: Traditional Themes and New Directions", in Finn, note 74 *supra*, 250-252, 260-263.

receivers is well-covered in the textbooks.[104] But, again there have been some interesting recent cases on these matters.

A. NO NEED TO PROVE

A recent case has affirmed the long-established rule that a secured creditor may stay out of the winding up procedure by relying only on its security. In fact, in the case, *Seventeenth Canute Pty Ltd v. Bradley Air Conditioning Pty Ltd*[105] the secured creditor had proved for the whole of its debt as part of a scheme of arrangement made after winding up, and therefore was held to have surrendered its security. The Supreme Court of Queensland (Connolly, Williams and Ambrose JJ.) held that only where the proof had been made by mistake or inadvertence might a secured creditor be restored to its security. A chargee may continue to let interest run and be secured by the charge after winding up, so long as again no proof is made by it.[106]

B. AVOIDANCE OF DISPOSITIONS AFTER WINDING UP (SECTION 368)[107]

A number of recent cases have affirmed that the property covered by a valid charge takes the property outside section 368 of the Code (avoidance of dispositions of property after commencement of winding up). It follows that this provision cannot be used by a liquidator to interfere with the realization by or for the chargee of its security. In *Re Country Stores Pty Ltd*[108], the company had in fact agreed to sell its entire undertaking on a Sunday only one day before the commencement of the winding up. It was held by Williams J. that the beneficial ownership passed to the purchaser on the Sunday and could not be attacked under the equivalent to section 368. His Honour followed *Re Margart Pty Ltd*[109], which did involve a floating charge and which charge was held to be unaffected by section 368.

Country Stores also contains the first reported consideration in Australia of *Aluminium Industrie Vaassen v. Romalpa Aluminium Ltd*[110] and reservation of title clauses. A supplier had supplied goods to the company on terms which reserved ownership. Insofar as the reservation of title clause affected goods supplied to the company winding up, it was held that the clause did not prohibit the company from on-selling the goods, even as part of a sale of its entire undertaking. The reservation of title

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104 See Morison, note 4 *supra*, paras 24.29 and 24.40, and Picarda, note 92 *supra*, ch. 14.
105 (1987) 11 ACLR 193.
106 *Re Securitibank Ltd* [1980] 2 NZLR 714.
107 Section 222 of the Companies Act 1955 (NZ).
108 (1987) 11 ACLR 385; (1987) 5 ACLC 636 (SC of Qld). Contrast *Re Arena Developments Pty Ltd* (1988) 12 ACLR 357.
109 (1984) 9 ACLR 269.
110 [1976] 1 WLR 676.

clause did not expressly give the supplier any claim to the proceeds of on-sales, and the judge was not prepared to imply such a term from a clause which made the company, as purchaser, the "fiduciary owner" only of the goods.

Consistently with *Country Stores*, where the purchaser was free to complete the conveyance of the business after the winding up, it was held in *Maughan v. Elders Finance & Investment Co Ltd*[111] that an equitable mortgagee can, where the agreement provides for this, elevate the mortgage into a legal one after the winding up. In fact, in *Maughan* the leases the subject of the charge were obtained by the company only following its winding up, hence the mortgage given before the winding up could only have been equitable under the principle in *Holroyd v. Marshall.*[112]

Re Margart, which has become a leading case on this aspect of section 368, has been recently followed in England in the judgment of Vinelott J. in *Re French's Wine Bar Ltd.*[113] The facts of the case are similar to those in *Country Stores.* A lease of land and the business carried on upon it were agreed to be sold, subject to the lessor's consent, shortly before the winding up of the company lessee. The learned judge held that the completion of the agreement to sell would be unaffected by the equivalent to section 368. However, he was troubled by the fact that the agreement for sale may have been conditional, and may not, therefore, have been amenable to specific performance.[114] So, in case he was wrong on this point, he was prepared to exercise his discretion to validate the disposition. *Sowman v. David Samuel Trust Ltd*[115] is also authority that the assets covered by a floating charge are not within the property caught by section 368.

Unfortunately, the effect of section 368 on a mortagee of land's power to carry on a business on the land (where no property interest in conferred in the business assets) does not appear to have been expressly argued in *Atkins v. Mercantile Credits Ltd.*[116] Although the above cases seem, at least in part, to have been based on the fact that a chargee has the beneficial ownership of the charged assets, it is arguable that section 368 would not adversely affect a power granted to a mortgagee of land to run the company's former business, when that power was conferred before winding up. At least, to argue otherwise would be to undermine the principal holding in that case, namely that the liquidator was bound by the power to the same extent as the company. Nonetheless, it may be advisable

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111 (1987) 5 ACLR 20 (SC of Qld) (McPherson and Derrington JJ., Connolly J. dissenting).

112 (1862) 10 HL Cas 191.

113 (1987) 3 BCC 173; [1987] BCLC 499. The judge understood *Re Margart* to be a decision of the "Equity Division of the Supreme Court of New Zealand". It is in fact a decision of the Equity Division of the Supreme Court of New South Wales.

114 Cf. the discussion of conditional contracts in *Maughan*, note 111 *supra.*

115 [1978] 1 All ER 622.

116 (1986) 10 ACLR 153. See the discussion of this case at the text corresponding to notes 1-6 *supra.*

when taking a charge over land for the goodwill of the business to be included in the charge, consistently with *County of Gloucester Bank v. Rudry Merthyr Steam & Coal Co.*[117]

C. EFFECT OF WINDING UP ON A CHARGEE'S POWER TO CARRY ON BUSINESS

Mercantile Credits is also authority that a winding up does not end the mortgagee's power to carry on the business. Other cases[118] had held that a chargee, or its receiver (the receiver ceases to be the agent of the company, and becomes either a principal, or, depending on whether the chargee intervenes in the exercise of the receiver's powers, agent of the chargee[119]), could continue to realize the secured assets after the winding up. However, it was not clear that the chargee could continue to run the business, except perhaps with a view to its sale or its more effective cessation. It now seems that the chargee can continue to run the business despite the winding up (it ceases to be the business of the company and becomes the business of the mortgagee[120]), but any debts incurred in so doing will not be provable in the company's winding up, being liabilities of the chargee or its receiver. The fullest discussion of this power to continue the business is found in the judgment of Needham J. at first instance.[121] This holding in *Mercantile Credits* may become inconvenient, because it implies that the final winding up of the company can be delayed indefinitely, so long as the chargee has not been fully repaid. Subject possibly to the liquidator's power to disclaim onerous contracts (section 454 of the Code, to be discussed next), it may be that powers ought to be given to the courts[122] in order to deal with this problem.

D. LIQUIDATOR'S POWER TO DISCLAIM PROPERTY AND CONTRACTS

Section 454(1) of the Code provides:

> "Subject to this section, where part of the property of a company consists of –
> (a) land burdened with onerous convenants;
> (b) shares in corporations;

117 [1895] 1 Ch 629, discussed at note 10 *supra.*

118 *Sowman v. David Samuel Trust Ltd* [1978] 1 All ER 616, where the older cases are collected.

119 *Re Wood* [1941] Ch 112; *American Express International Banking Corp v. Hurley*[1985] 3 All ER 564; *R.A. Price Securities Ltd v. Henderson* (1989) 3 BCR 230 (NZCA).

120 Thus not being affected by s.377(1)(a) of the Code (powers of liquidator) (s.240(1)(b) of the Companies Act 1955 (NZ)), or s.394(1) of the Code (effect of voluntary winding up on business and status of company) (s.271 of the 1955 Act (NZ)).

121 (1985) 9 ACLR 757.

122 See in New Zealand the partial solution found in s.346A of the Companies Act 1955, which permits the Court to terminate a receivership.

> (c) property that is unsaleable or is not readily saleable; or
> (d) unprofitable contracts,
> the liquidator . . . may . . . disclaim the property . . .[123]

Read literally this provision would seem to permit a liquidator to disclaim any contract of mortgage as an "unprofitable contract", let alone a contract conferring a mere power to seize assets. However, Jessel M.R., as long ago as 1880, said of a similar provision that:

> What the section precisely means I, for one, do no pretend to say, and whether it is possible to construe it in some shape or other so as to prevent its doing the mischief which it seems to produce in the present case, I am unable to state.[124]

It is considered that section 454 would not permit a liquidator to disclaim a mortgage or a power to seize and sell. Certainly, there appears to be no instance, in well over 100 years of the wording found in section 454, of a court allowing the disclaimer of a mortgage, and it has been consistently held that a liquidator cannot use the power to disclaim a contract to defeat a property interest conferred by that very contract on the other party.[125] In *Dekala,* Young J. approved the statement of Mr. Melville that:

> "It is probably true to say that "unprofitable" means, not simply a bad bargain, but one the performance of which cannot satisfactorily be carried out by a trustee in bankruptcy."[126]

Since a liquidator need only stand by while a mortgagee realizes its security or a licensee exercises its power of sale, it cannot be said, it is submitted, that the liquidator need do anything onerous in respect of the contract. However, it has been held that a liquidator can disclaim the company's equity of redemption in mortgaged land because of onerous terms in the mortgage (it seems that the equity of redemption may revert to the Crown)[127], with the consequence that the obligations of the mortgagor under the mortgage including those to pay principal and interest, cease, although the mortgage will continue to bind the land to the extent of the principal and interest owing at the date of disclaimer. It is respectfully submitted that two contrary New Zealand cases, which hold that a mortgage (at least one not containing unusual terms) does not

123 The equivalent New Zealand provision is s.312(1) of the 1955 Act. It is submitted that s.312 is exhaustive of the ability of a liquidator to disclaim contracts and other property, and that the more extensive provisions of ss75-76 of the Insolvency Act 1967 (NZ) are not incorporated into the Companies Act pursuant to s.307. This question does not arise in Australia in relation to s.133 of the Bankruptcy Act (Cth).

124 *Re Mercer and Moore* (1880) 14 Ch 287.

125 See *Re Bastable* [1901] 2 KB 518; *Dekala Pty Ltd v. Perth Land and Leisure Ltd* (1988) 6 ACLC 131. Cf. *Re Jandowae Estates Pty Ltd* (1989) 7 ACLR 179 (disclaimer by lessor of unprofitable lease); *Richmond Commercial Developments Ltd v. Sanyo NZ Ltd* (1990) 3 BCR 586.

126 L.W.Melville, "Disclaimer of Contracts in Bankruptcy" (1952) 15 MLR 28. See also *Re Potters Oils Ltd* [1985] BCLC 203.

127 *Re Middle Harbour Investments Ltd* (1976) 2 ACLR 226; *Re Richardson's Meat Industries Ltd* (1989) 15 ACLR 343.

burden the land with onerous covenants sufficient to allow a freehold interest to be disclaimed, are to be preferred.[128]

E. EFFECT OF WINDING UP ON RIGHTS OF CHARGEE TO APPROPRIATE A DEPOSIT WITH IT BY THE CHARGOR

One other recent case of relevance to the chargee on a winding up is *Re Charge Card Services Ltd.*[129] Where the chargee is a bank, and its company customer has a deposit to its credit as well as a debt, usually an overdraft, owed to the bank supported by floating charge, *Charge Card* (though itself concerned with rights of retention against the company's customers) is authority that the deposit is not covered by the charge. The bank has a right of set-off or retention only, which after winding up, at least in relation to a right of set-off only, becomes restricted to the circumstances in which set-off is permitted by statute.[130]

128 See *Re Rickman; ex parte The Bank of New Zealand* (1890) 8 NZLR 381, followed (albeit not without question) in *Brigg v. Harcourt* (1911) 31 NZLR 366.

129 [1987] Ch 150; [1986] 3 All ER 262, aff'd on appeal on another point [1988] 3 WLR 723. See the criticism of this case by P.R.Wood, "Three Problems of Set-off: Contingencies, Build-ups and Charge Backs" (1987) 8 *Co Law* 262. And see T.Shea, [1986] *JIBL* 192. Contrast C.Bamford, (1988) 7 *IFLR*, May 8, and D.Pollard, "Credit Balances as Security" [1988] *JBL* 127, 219; W.Blair "Cash Deposits as a Form of Security" [1987] *Butterworths Banking and Financial Law Review* 163.

130 See Morison, note 4 *supra*, paras 40.30-40.31. As to ways to avoid the difficulties arising from the inability to take a charge over ones own liabilities, see R.Parsons,"Re-Drafting Bank Security Documents Following Charge Card" [1987] 3 *JIBL* 165.