

International Corporate Rescue



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No Assets, No Problem: Court of Appeal Upholds Validity of Floating Charge Even in the Absence of Any Assets to which the Charge Could Attach

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Introduction

In the recent decision *SAW (SW) 2010 Ltd and another v Wilson and others* [2017] EWCA Civ 1001, the Court of Appeal considered the validity of the appointment of administrators by the holder of a purported qualifying floating charge which had been granted in breach of the terms of a prior floating charge, thereby triggering crystallisation of the prior charge. The central issue was whether the later floating charge was valid given that, at the time it was created, there were no unencumbered assets to which it could have attached.

Factual background

In December 2007, Property Edge Lettings Limited (the 'Company') obtained a £1.25 million facility from, and granted security to, Capital Home Loans Limited ('CHL'). The security included various fixed charges and a floating charge over the remainder of the Company's undertaking, property and assets (the 'First Charge'). In the debenture granting the First Charge, the Company undertook not to create any other security interest in the property subject to the charge without CHL's prior consent. The debenture stipulated that if this covenant was breached, the floating charge would automatically crystallise into a fixed charge (the 'Crystallisation Clause').

In May 2008, the Company borrowed £3.9 million from Derbyshire Building Society ('DBS') to finance the acquisition of development land. The Company granted security to DBS in the form of a fixed charge over the acquired land and a floating charge over all of its other assets (the 'Second Charge').

CHL's consent was not obtained in relation to the Second Charge. As a result, the Crystallisation Clause in the First Charge was triggered, although there was no evidence that this was known by the Company, CHL or DBS at the time. The Second Charge was subsequently assigned by DBS to Nationwide Building Society ('Nationwide').

When the Company began to experience financial difficulty Nationwide sought to realise its security.

Nationwide obtained CHL's consent to the appointment of administrators and proceeded to appoint administrators over the Company in January 2012.

Over three years later, in June 2015, SAW (SW) 2010 Limited, a shareholder and creditor of the Company, and Neil Wilson Accountancy Limited, a creditor of the Company (together, the 'Appellants'), applied to challenge the validity of the administrators' appointment. The Appellants argued that the Second Charge was invalid and unenforceable, mainly on the basis that once the Crystallisation Clause in the First Charge was triggered, there were no assets over which the Second Charge could attach.

HHJ Hodge QC heard the case at first instance, in the Manchester District Registry of the Chancery Division, and dismissed the application.

The Court of Appeal decision

The Court of Appeal unanimously dismissed the appeal, with Briggs LJ and Arden LJ giving separate reasons.

In his analysis Briggs LJ focussed on the Appellants' argument that the triggering of the Crystallisation Clause in the First Charge meant that at the time the Company granted the Second Charge, the Company neither had uncharged assets to which the Second Charge could attach, nor had the power to acquire such assets in the future. Briggs LJ found that nothing in the relevant authorities supported the Appellants' submission that the validity of an instrument as a floating charge depends on the existence, at the time of its creation, of uncharged assets of the chargor, or upon a power of the chargor to acquire unencumbered assets in the future.

Briggs LJ noted that *Re Croftbell* [1990] BCC 781 directly contradicts this argument and highlights two very practical commercial reasons why a company may grant a floating charge at a time when it has no unencumbered assets. When first commencing business, before a company has any significant assets, it may wish to borrow working capital and grant a floating charge that extends to future assets. Secondly, if there is a prior fixed charge over all or a part of the

company's property, a subsequent floating charge can attach to the company's equity of redemption under the fixed charge (which could be quite valuable).

Briggs LJ also rejected the Appellants' argument that the Second Charge was unenforceable for as long as the assets to which it related were the subject of prior security. Paragraph 15 of Schedule B1 of the Insolvency Act 1986 expressly contemplates a junior ranking qualifying floating charge holder appointing an administrator (after giving notice to prior ranking creditors), thus it would be inconsistent with the statute if the crystallisation of a prior ranking charge rendered a junior ranking charge unenforceable.

Briggs LJ confirmed that a floating charge is enforceable if any condition precedent to enforcement has been satisfied and there remains a debt owing which the charge secures. The question is whether the chargee has the right to enforce, not whether there are any assets against which the charge can be enforced.

Arden LJ's judgment accepted a number of Briggs LJ's conclusions. She agreed that there is no inherent requirement that a company has assets which fall within the floating charge at the moment of its creation in order for the charge to be validly created, but pointed out that, in any event, there were 'clearly assets in this case ... such as the equity of redemption in the property charged to CHL.' She also agreed that there is no requirement for there to be assets of value within a floating charge in order for it to be enforceable.

Arden LJ also specifically considered the timing of the crystallisation of the First Charge. The Crystallisation Clause in the First Charge stated that it would have effect '*instantly*' if the relevant covenant was breached. She found that '*instantly*' meant '*forthwith*' or '*immediately upon*'. Therefore, on her interpretation, the

crystallisation of the First Charge occurred only after (albeit immediately after) the creation of the Second Charge, and as such, at the time of creation of the Second Charge, the First Charge had not yet fixed upon the assets of the Company.

Conclusions

Whilst not focused on by Briggs LJ or Arden LJ, it is noteworthy that the prior security holder in this case, CHL, was not one of the parties challenging the appointment of administrators. To the contrary, even though the grant of the Second Charge breached a covenant in CHL's favour, CHL expressly consented to the appointment of administrators by Nationwide. As a contractual matter, the Crystallisation Clause in the First Charge was clearly intended for CHL's benefit, but in this case, the Appellants sought to rely on the legal consequences of this clause to support their position.

This case provides helpful clarity that the validity of a floating charge does not depend on the chargor having unencumbered assets at the time of creation of the charge. This is comforting reassurance for lenders who often consider a floating charge a 'catch all' for all of the company's present and future assets, and do not necessarily consider in detail the precise assets over which it will apply.

This case also reassures security holders that a floating charge will not be rendered invalid by the existence of prior security over the same assets. The existence of prior security over the same assets of course remains relevant to the priority of a subsequent floating charge, but it does not impact the validity of the subsequent floating charge.

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