FLOATING CHARGE: A CHILD OF EQUITABLE CIRCUMSTANCE AND ITS HYBRID DISPOSITION*

Abstract
The recent global economic recession has further brought to the fore the need for secured credit transaction in the economy as well as the law governing credit taking. Nigeria and indeed many countries across the globe had a fair share of this global challenge. As a corollary, banks and other financial institutions dealing on credit became more conscious in their credit dealings with the aim of minimizing their exposure to any risk especially as it relates to non-repayment of loans advanced to the debtors. Floating charge, which is a creation of equity, has remained one of those mechanisms adopted by the Banks in securing the loans and ensuring their repayment. Despite its extensive use in modern commercial transactions, the floating charge mechanism and its underlying concepts and law have been plagued with controversies, uncertainty and unnecessary complexity. This paper is aimed at dissecting the laws behind the floating charge mechanism, especially in relation to the distinction between fixed and floating charges and its importance in dealing with charges over book debts.

Key words: *Floating charge, Fixed charge, Debenture, Secured Debenture*

1. Introduction
Credit can be classified into two categories, one extended by money lenders and the other by banks and financial institutions. On account of very high rates of interest charged by the money lenders and strong-arm methods used for recovery, there is a stigma attached to money lending activity in the context of credit extended by money lenders, hence credit has earned a bad name and evoked comments such as "private control of credit is modern slavery", "debt is the slavery of the free " or "debt is the worst poverty"[1].The other lending activity regulated by Central Banks is undertaken by the banks and financial institutions. The credit extended by the banks and financial institutions is for various economic activities; and to cover the credit risk, banks do demand security for credit extended. Modern economists call credit a blessing, the driving force of business and an engine for business growth. A credit extended say for buying a truck achieves sale of the truck by the manufacturer and also provide a means of undertaking transport business by the person who purchases the truck and pays for the truck in installment. As far as the probability of default in servicing the credit is concerned, the truck itself can be used as a security which can be repossessed and sold in the event of default, such credit is a secured transaction[2].

It is obvious that, for business owners or a company to grow and achieve its set objectives, capital is a necessity. This capital requirement of companies may not be met by its shareholders especially under the new dispensation which allows the company to carry on a wide variety of businesses as a going concern under the provisions of the Companies and Allied Matters Act (CAMA).[3] Most Companies resort to borrowing to meet their capital requirement providing assurances by issuing debentures secured by a charge on the company's assets[4].

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*By **Uwadineke C. KALU**, **PhD (Law),** Senior Lecturer/HOD, Dept. of Commercial & Property Law, Faculty of Law; Nnamdi Azikiwe University, Awka, Anambra State. E-mail: uwadinekekalu@yahoo.com, 08037727063; **Ejike Francis OKAPHOR, LLM** (UniLag) Lecturer, Department of Public & Private Law, Faculty of Law, Nnamdi Azikiwe University, Awka, Email: pushejyke@yahoo.com. 08033944889; and **Bryan OLEKANMA,** LLM (UniLag), Principal Counsel, Bryan Olekanma & Associates, 2nd Floor, Tapa House, 3/5 Imam Dauda Street, off Eric Moore Surulere, Lagos: E-mail: bryan.olekanma@gmail.com. 08158558097.

[1]M R Umarji, *Modern Law for Global Commerce: Role of Secured Transaction to Mobilize Credit and Mobilizing the law* (2007) p.1

[2]*ibid*

[3]Companies and Allied Matters Act,Cap C20, LFN, 2004.

[4] I O Smith, *Nigerian Law of Secured Credit* (Lagos: Ecowatch Publication Nigeria Ltd ,2001) p. 291.

2. Conceptual Clarifications

For a clearer appreciation of this study, it is apposite to define certain recurrent terms. Hence, a floating charge is a security (that is mortgage, lien etc) that has an underlying asset or group of assets which is subject to change in quantity and value.[5] It is a security interest over a fund of changing assets of a company or other artificial person, which 'floats' or 'hovers' until the point at which it is converted into a fixed charge; at which point the charge attaches to specific asset of the business.[6] This conversion of the floating charge into a fixed charge known as crystallization can be triggered by a number of events which may vary from country to country. For instance, in most common law jurisdictions, it is an implied term in security documents creating floating charges that a cessation of the company's right to deal with the assets (including by reason of insolvency proceedings) in the ordinary course of business leads to automatic crystallization.[7]

Debenture on its part is a debt secured only by the debtor's earning power, not by a lien on any specific asset.[8] It is an acknowledgement of the company's indebtedness hence not secured by physical assets or collateral. In corporate finance, a debenture is a medium to long term debt instrument used by large companies to borrow money, at a fixed rate of interest[9].They are backed only by the general credit worthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond in order to secure capital.[10] In practice, it is rare that creditors would accept naked debentures, more often than not; hence the company is required to charge its assets as security. Thus, a secured debenture is that which is secured either by fixed charge on the specific or ascertainable company properties or by a floating charge over the whole or a specified part of the company's undertaking and assets or by both.[11] If the company goes bankrupt, holders of secured debentures have a clear claim on the assets securing their bonds and no other creditors have a claim on those assets.

3. The Nature of Fixed Charge

On its part, a fixed charge is a lien or mortgage on a specific fixed asset such as a parcel of land, plant and machinery to secure the repayment of a loan.[12] It is a security[13] whereby the debtor's property is appropriated by the creditor so that on default by the debtor, the creditor is entitled to pursue certain remedies against it and not merely against the debtor, for the discharge of his debt or obligation[14]. In this arrangement, the asset is signed over to the creditor and the borrower would need the lender's permission to sell it. The lender also registers a charge against the asset which remains in force until the loan is repaid. Under a fixed charge mechanism, neither possession nor title is passed to the creditor as far as the property is concerned. He only acquires certain rights or interests of a proprietary nature or character, such that even when the debtor disposes or alienates the charged property, the interests or rights

[5]http://en.m.wikipedia.org/wiki/floating_charge accessed on 10th February, 2016

[6]*ibid*

[7]*ibid*

[8] B.A Garner (ed), *Black's Law Dictionary* (7th Ed, United States of America, 2001) p.408

[9]https://en.m.wikipedia.org/wiki/Debenture accessed on 17th February, 2012

[10]*ibid*

[11] Companies and Allied Matters Act, S.173(2)

[12] N C S Ogbuanya, *Essentials of Corporate Law Practice in Nigeria* (2nd Ed, Lagos: Novena Publishers Ltd, 2014) p.537.

[13] For us, security is created where a person (the creditor) to whom an obligation is owed by another (the debtor) by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains rights exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtor's obligation to the creditor; W J Gough, *Company Charges* (London: Buttworths, 1996) p.4, Also the case of *Bristol Airport Plc* v. *Powdrill* (1990) 2 All ER 493 at 502 refers.

[14] E Essien, *Law of Credit and Security in Nigeria* (Uyo: Golden Educational Publishers, 2000) p. 64.

subsists over the property despite any change in ownership.[15] Similarly, where the debtor goes bankrupt, the creditor can submit proof of debt and be considered in the distribution of dividend. He may also exercise other remedies against the property itself or against the trustee in bankruptcy.[16] Fixed charges can be legal or equitable in character or nature. It is legal where it is in form of a deed and it gives the chargee the same rights of a legal mortgage. If it is through the deposit of title deed with the chargee, it is equitable and it confers the rights of equitable mortgage.

The cardinal importance of fixed charges speaking from the standpoint of a charge is that particular assets are earmarked and kept available to satisfy the claim to redeem the debt, as the company cannot dispose of the assets or create other charges ranking in priority to the present charge.[17] The legal or fixed charge or mortgage is accorded the right to retain the title deeds. It does not involve the transfer of interest to the mortgage. Invariably, any subsequent mortgagee or purchaser is properly notified of the interest of that mortgage. He is properly placed on notice. The notice here is actual notice. Other advantages of fixed charges include that it is a more convenient means of transferring several properties, even if the interests are of different nature (such as freehold and leasehold) in the same form by merely describing them at the schedule without any detail or actual conveyance. Again, a fixed charge is easy to annul or discharge. Only a statutory receipt can do this as there is no need for a formal Deed of Reconveyance or Deed of Release. This can be gathered or understood from Section 135 of the Property and Conveyance Law.[18] The legal or fixed charge is again advantageous since in the words of Oniekoro,

> The use of a statutory charge is a convenient means of circumventing the restrictions against assignment or sub-letting. Since a charge does not involve the transfer of interest to the chargee, where the lessee uses a statutory charge, it cannot be held to have breached the covenant against assignment or sub-letting. Yet the chargee is vested with powers of any other mortgagee with interest[19]

The obvious demerit of the fixed charge is that since it only requires a receipt which is not registrable, the general public may not have notice of the discharge of the mortgage. There is a snag that the fixed charge has and it is that

> The asset which has been chosen as a security may lose its value even where the other assets of the company are retaining their value or even appreciating. Thus, since under a fixed charge, the debenture holder's security is the assets chosen, the debenture holder cannot proceed against the other assets of the Company but are confined to the assets comprising the fixed charge. Also, the inability of the debenture holder to deal with the charged assets without the consent of the charge makes fixed chargee unattractive to commercial

[15] N C S Ogbuanya (n. 14) p.537; R M Gorode, *Legal Problems of Credit and Security*, (2nd Edition, London, Sweet and Maxwell, 1988) p.15.
[16] E I Sykes & S Walker, *The Law of Securities* (Australia: The law Book Company, 1993) p.18. Note, that the charge does not generally have my right of sale of the property except where specifically provided by law such as under S.112 of the Property and Convincing Act Cap. 100, Laws of Western Nigeria, 1959.
[17] N C S Ogbuanya (n. 14). p. 538
[18] F J Oniekoro, *Mortgages in Nigeria; Law and Practice* (Enugu: Chenglo Ltd, 2007) pp. 77-78.
[19] *Ibid* p.78.

> companies that may not have fixed assets or are not willing to encumber specific assets of the company just to obtain a lifesaving loan for the company[20]

4. Evolution of Floating Charges

Pennington in his seminal work observed that the floating charge mechanism was born out of necessity of times[21]. The rapid expansion of industry and commerce due to the Industrial Revolution in nineteenth century Britain resulted in an insatiable need of both equity and debt capital by companies. The former relates to the raising of capital through share issues[22]. The latter, on which this essay is focused, is the 'lifeblood of the modern industries economy[23]; and relates to the issuing of debt security or by borrowing from banks or other lenders. The need for security was further accentuated by the Joint Stock Companies Act and Companies Act[24], the primordial acts of modern English Company Law which provided a cheap and straightforward way of allowing traders to incorporate limited liability companies, the advent of which increased the risk borne by creditors and providers of debt capital.

Limited liability companies, newly endowed with separate corporate personalities, were liable for their own debt; shareholders were no longer liable for the debts and liabilities of the company and could not be sued by the company's creditors. Creditors therefore needed to be satisfied that they had sufficient security for their loans, and the taking of security over a debtor's undertakings, that is, the entirety of their present and /or future assets became common practices Problems arose as these encompassed assets of which the debtor required to dispose or make use of in the ordinary course of its business such as stock-in-trade and book debts. As the creditor had a charge over them, the debtor required the creditor's consent every time it wished to use or dispose of these assets and any reluctance by the creditor to do so could halt the debtor's business. The common law was indifferent and offered little redress to this state of affairs and it was also constrained by the rigid rules and maxims forming its foundation[25]. It was clear however, that the charge mechanism in its rudimentary form could not strike an adequate balance between protecting the creditor's security over a debtor's undertakings' on one hand, and allowing the debtor to continue to operate its business and deal with charged assets free of the creditor's interference on the other.

Floating Charge is an equitable charge on all or any of the company's property or assets, the constituent items of which are constantly changing. It is an invention of equity dictated by business exigencies of the times and its course has been influenced by the ingenuity of draftsmen and statutory provisions[26]. It was Lord Macnaghten's statement in *Government Stock and other Securities Investment Co* v. *Manila Railway Co*.[27] that:

> A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is of the essence

[20] N C S. Ogbuanya (n. 14) p. 538
[21] R Pennington, *The Genesis of the Floating Charge* (1960) 23 MLR 630, 630-31
[22] E Ferran, *Principles of Corporate Finance* (London: Oxford University Press, 2008) p. 85.
[23] Report of the Review Committee (Cork Committee), *Insolvency Law and Practice* (Cmd 8558, 1982) para 10
[24] 1856 and 1862 respectively
[25]The enormous demand for credit by businesses could only be met by a fixed charge which restricts the company's power to deal with the charged asset in the ordinary course of business and consequently, reducing the company's prospect of repayment of loan through profitable business venture.
[26] Companies and Allied Matters Act, SS 178,179-209
[27] (1904) A.C. at 355

> 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.

Also the Supreme Court case of *Inter-Contractors Nigeria Limited* v. *UAC*[28] adopted the common law definition and held that "floating charge is ambulatory and floats over the property until the event indicated in the debenture deed happens which causes it to settle, remain fixed and crystallize into a fixed charge"

Floating charge is intricate in the sense that it fluctuates with the assets of a going concern both present and future, meaning that even if a company acquires new assets it binds them or even when they sell the old or existing assets and buy new ones to replace them, it also binds them. Interestingly, even if assets covered by floating charge are converted to cash by way of sale, it follows the cash, the stocks or whatever nature the assets of the company are held or put. Buckley L.J[29] aptly put it thus:

> Floating Security is not a future security. It is a present security, which presently affects all the assets of the company expressed to be included in it. On the other hand, it is a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that mortgagor can deal with them without the concurrence of the mortgagee. A floating security is a not specific mortgage of the assets, plus a license to the mortgagor to dispose of them in course of is business, but is a floating mortgage applying to every of them comprised in the security, but not specifically affecting any item until an event occurs or some act on the part of the mortgage is done which caused it to crystallize into a fixed security[30].

The Company and Allied Matters Act (CAMA)[31] in Section 178 (1) defined "floating charges" as:

> an equitable charge over the whole or a specified part of the company's undertakings and "assets" including cash and uncalled capital of the company both present and future, so that the charge shall not preclude the company from dealing with such assets until- (a) The security becomes enforceable and the holder thereof, pursuant to a power in that behalf in the debenture or in the deed securing the same, appoints a receiver or manager or enters into possession of such assets; or.(b) The Court appoints a receiver or manager of such assets on the application of the holder; or (c)The company goes into liquidation.

The above definition tried to enlarge the common law position on the nature of floating charge. It is apparent therefore that floating charge is characterized by three main features;

a. It is a charge on a class of assets both present and future.

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[28] (1988) 2 NWLR (pt. 76) p.303 at 322
[29] *Evans v Rival Granite Quarries* (1916) KB p. 979 at p.999
[30] I A Eyo, 'Distinction between Fixed and Floating Charges and the Issue of Crystallization' (2008) 1Port Harcourt Journal of Business Law, vol 1, 23-38.
[31] Cap. C20 LFN 2004

b. The class of assets is one which in the ordinary course of business of the company would be changing from time to time and,

c. It is contemplated that, until the charge attaches to assets by the crystallization, the company may dispose of or deal with the assets in the ordinary course of business. The expression ordinary course of business is construed widely to cover the sale of the whole undertaking including payment of unsecured creditors and power to grant mortgages on the same property unless otherwise provided in the charge instrument[32]

The nature of floating charge flowing from the above description and definitions is straightforward and uncomplicated. It is readily explicable in light of its historical development; hence floating charge has a proprietary interest in the debtor's assets from the time the charge is created. However, apart from theoretical issues that may arise, the nature of a floating charge seems to pose no significant problems in practice. Theories about the nature of floating charges are much less important than the effect of floating charges in practice. It has become more important in practice to distinguish between fixed and floating charges[33]

5. Intervention of the Doctrine of Equity

The floating Charge is no doubt a creation of English equity, Equity first intervened in *Holroya* v. *Marshall*[34], where the issue of whether after-acquired property was subject to a charge in favour of the secured creditor who had never taken possession of the new machines. The House of Lords definitely confirmed that any future asset within the description of the charge automatically become charged to the creditor once the decision, envisaged the original mortgage as a contract that is self-executing as soon as the mortgagor acquires the property. A series of cases following Holroya confirmed the possibility of a charge over all present and future property of the debtor. Equity's ingenuity further prevailed in devising a solution to the problem of paralyzing the entirety of the debtor's business – there was an implied agreement by creditors that the debtor could carry on its business and deal with the property until the former were entitled to intervene and enforce their rights under the charge. The courts essentially gave effect to the parties' contractual intentions by implying an authority by the creditor to enable the debtor to carry on its business notwithstanding the charge.

Sixteen years after Holroya was decided, Lord Chelmsford's approach was resonated in the later House of Lords decision of *Tailby v. Official Receiver*[35]. Lord Macnaghten reasoned that the contract is regarded in equity as binding on the conscience of the assignor and so binds the subject matter of the contract when it comes into existence, regardless of the property being current or future as long as they are ascertainable and identifiable, rejecting Lord Westbury's reliance on specific performance in Holroya. Taken together, the series of cases between Holroya and Tailby effectively allowed the creation of a charge over all of a debtor's present and future assets. Establishing what will later be identified as the first floating charge proper in English Law[36], which by extension is part of Nigerian law. The nature of the floating charge

[32] Per Romer J *In Re Yorkshire Woolcombers Association Limited* (1903) Ch. P.284 at p. 295; see also I.O. Smith (N.4) p. 302-303, LCB Gower in his Principles of Modern Company Law (5th ed). (London, Sweet & Maxwell, 1992) p.16 described a floating charge as "a charge which flats like a cloud over the whole assets from time to time falling within a general description, but without preventing the company or mortgagor from disposing of these assets in the usual course of business until something occurs (as stated in S.178(i) (a) – (c) CAMA) to cause the charge to become crystallized or fixed.

[33] Wen yie Tan (n.29) p.12.

[34] (1862) 10 ELC, 191

[35](1888) 13 AC 523.

remains shrouded in complexities, as suggested by judicial decisions from the genesis of the concept. However, it is necessary to examine the nature of the floating charge to develop a proper understanding of floating charges and the implications that flow from it[37].

6. Floating and Fixed Charges Distinguished

The dynamics of the floating charge as explained above was accurately summed up by Romer LJ in *In Re Yorkshire WooIcombers Association Ltd*[38], in a statement which has since received wide judicial acceptance. The fixed charge on the other hand attaches to specified fixed assets such as land and machinery, giving the chargee an immediate proprietary interest in the assets subject to any prior existing interest where notice has been given and an agreement has been reached with the chargor. However, the chargor is not permitted to deal with the charged assets in any way without the prior consent of the chargee[39]

Therefore, contrary to the views of some commentators, the floating charge is not an entirely different type of charge from a fixed charge. The only apparent difference from a theoretical point of view is that under a floating charge .the debtor has prospective general authority to deal with his assets in the ordinary course of business free from the charge prior to crystallization, while a debtor having created a fixed charge would require the specific authority of the creditor each time he wishes to deal with the asset concerned[40] The distinction therefore, is one related to the issue of the freedom of the debtor to deal with assets and the level of control by the creditor over the same. It can be summarized succinctly as follows: where the charge is fixed the chargor needs to obtain the chargee's permission for any disposal of charged assets. Where the charge is floating the chargor may use the charged assets in the ordinary course of business without reference to the chargee,[41]

However, the position in practice is much more difficult; the problem lies in deciding how much freedom to deal with the charged assets is consistent with a fixed charge, a recurring issue evident in case law surrounding charges over book debts. A delicate balance needs to be struck between the freedom of the debtor to deal with assets on one hand and the control retained by the creditor on the other, the failure of which could result in the relegation of a fixed charge to that of its floating counterpart, entailing implications that potentially negate the purpose of the taking of security. Although in practice all floating charges contain express restrictions on the debtor's abilities to deal with the charged assets, such as the presence of a negative pledge clause.

Negative pledge clause is a drafting device introduced into the concept of floating charge to meet the difficulties which the freedom of the company to carry on in the ordinary course of

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[36] Wen Yie Tang, 'The Elusive Floating Charge' The Student Journal of Law <https://sites.google.com/site/349924e64e68f035/issue-6/the-elusive-floating-charge> accessed on 23rd October, 2012

[37] Wen Yie Tang (n.29) p.8

[38](1903) 2 CH 295

[39]See among others, Hoffman LJ of the House of Lords in *Smith (Administrator of Cosslett (Contractors) Ltd v. Bridgend County Borough Council* (2002) 1 AC 336; 352; and Tompkins J in Supercool Refrigeration and Air Conditioning v. Hoverd Industries Ltd (1994) 3 NZLR 300

[40]Richard Calnan, 'Floating Charges: A Proposal for Reform" (2004) 9 JIBFL 345

[41]D Capper, 'Spectrum Plus in the House of Lords: The Victory of Substance over Form in Personal Property Security law' (2006) 6 JCLS 447, 448; N C.S. Ogbuanya op-cit p.539-540 maintains that "floating charge can best be described as an immediate charge on future assets existing at the moment of crystallization. A major significant feature of floating charge is that the company retains management autonomy with respect to the assets subject to the charge".

business has given rise to. This clause is a covenant binding the company not to without the consent of the debenture holder, grant subsequent security ranking in priority or *paripassu* with the existing charge[42]. On the other hand, a debtor dealing with charged assets in a limited way will not relegate a fixed charge into a floating charge. Professor Calnan provides the examples of a fixed charge over land which has the benefit of a lease. The debtor remains and will remain entitled to the rental income until the creditor enforces the charge. It is only upon enforcement that the creditor itself becomes entitled to the rents. Similarly, a purported fixed charge over an asset which dissipates over time does not convert it to a floating charge by the mere fact that the quality or quantity of the asset varies over time. In both of these circumstances, there is no doubt that the creditor has a fixed charge even though the debtor has the benefits until enforcement[43],

Nonetheless, the beauty of the floating charge is self-evident. The freedom conferred on the debtor company to deal with charged assets is unrivalled by that of the fixed charge. It provides security when it is needed, that is when the debtor became insolvent, but it does not interfere with the ability of the debtor to deal with the charged assets[44]. In the meantime, it allows the debtor to sell its stock-in-trade and make use of the proceeds of book debts to pay employees and trade creditors, therefore enabling the company to function.

In the opinion of Eyo, concerning the advantages and disadvantages of a floating charge,

> a floating charge has some advantages and this includes that the company can use the charged assets in any of the ways…… such as mortgaging, leasing etc and use the proceeds of the charged assets until the charge is intervened. Secondly, a floating charge, though it could also relate with future assets of a company, is itself a present charge and not a future one when the charge is enforced or when it crystallizes. Thirdly, the Courts have emphasized the flexibility of a floating charge and said that its terms are as those agreed upon by the parties and there is little or no judicial intervention with this process.
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> ….. Since the holder of a floating charge is not solely concerned with the rights which it provides against the Company. But he is also concerned with the priority it provides against other Charge holders, a floating charge provides less than a perfect security because a floating charge will be deferred to in favour of any subsequent fixed legal or equitable charge created by the company over its assets. Secondly, if debts due to the company are subject to a floating charge, the interest of a floating charge will be subject to any lien or set-off that the Company creates with respect to the charged assets prior to the crystallization. However, once a floating charge crystallizes, this affects an assignment of the assets subject to the charge with the result that the assets are no longer those of the company….

[42] CAMA, S.179 provides "A fixed charge on any property shall have priority over a floating charge affecting that property, unless the terms on which the floating charge was granted prohibited the company from granting later charge and the person in whose favour the later, charge was granted had actual notice of the prohibition at the time when the charge was granted. The operational sentence is that there must be actual notice of the later charge.

[43] Richard Calnan (n.42) p.345

[44] David Capper, 'Fixed Charges over Debts- the Future after Brumark' (2003) 24 Comp Law,p. 325- 326.

> The floating charge can be quite vulnerable…. on the whole, despite the vulnerability of floating charge, creditors obtain one for reasons such as … where a subsequent holder of a registrable charge has notice of a negative pledge clause; it accords a floating charge priority over it. Also a floating charge provides security against unsecured creditors and the floating charge holder will be liable to take steps to enforce. The charge, while this also gives him considerable control over the company's affairs. Lastly, since the holder of a floating charge will have some measure of control over the company, he can, amongst other controls, block the appointment of an administrator.[45]

However, this attraction fades with legislative inroads advanced by the English Parliament. The intervention of statute since the late 19th Century has required the courts to draw a clear distinction between fixed and floating charges. Hence, there are five principal reasons as to why the distinction must be drawn; these are largely centered on the issue of priority in the insolvency of the debtor. The first relates to the requirement of registration of company charges, as all floating charges must be registered, while only certain fixed charges require registration. It is important to note that in Nigeria floating charges on land are excluded from such registration in the Corporate Affair Commission following the Supreme Court's decision in *JIA Enterprises & ors* V *British Common Wealth Insurance Company*[46]. Therefore, registration of charges relating to lands does not end at the company Registry and Corporate Affairs Commission because various land registration laws in Nigeria also required other form(s) of registration for charges relating to land. The conclusion was premised on the ambulatory nature of the floating charge for registration. The main consequence of non-registration is that the charge holder will lose his priority in insolvency[47].

Secondly, in the administration or liquidation of the debtor, the fixed charge has priority over all unsecured claims including preferential claims. It is liable to be set aside only if it amounts to a preference, that is, if the creditor is connected with the debtor. Floating charges on the other hand are more vulnerable to the claw-back provisions of the Insolvency Act 1986 of England and challenges in liquidation. A floating charge given by an insolvent company within 12 months prior to the onset of insolvency is void if the debtor was insolvent at the time it was given, except as to new value. However, in Nigeria Section 498 (1) of CAMA provides that a floating charge created within three months of commencement of winding up of company shall be invalid unless it is shown that the company immediately after the creation of the charge became solvent.

Thirdly, dissatisfaction with the capacity of a floating charge to take virtually all of the debtor's assets has led to the extension of the rights of preferential creditors such as employees, the taxation office and other government bodies to receive payment in insolvency in priority over floating charges.[48] Fixed charges on the other hand have priority over all unsecured claims, preferential or otherwise. A floating charge would therefore rank after preferential claims if the latter cannot be satisfied by the other assets of the company, potentially leaving very little or nothing for the floating charge holders whilst paying the preferential creditors in full. This is perhaps an expected outcome, given the propensity of some company directors to trade at the

[45] I A Eyo, (n.36) p 25-35
[46] (1962) ANLR 363
[47] Commercial Law- Text, Cases and Materials LS Sealy & RJA Hooley – Second Edition Buterworths, p. 918
[48] Companies and Allied Matters Act, S. 494(1)

expenses of preferential creditors' as one commentator puts it. However, the enactment of the Enterprise Act 2002 of England abolished Crown preference, thereby largely restricting preferential claims to claims by employees.[49] In Nigeria, however, preferential claims are not restricted to employee's claims but extend to rates and taxes due from the company within twelve months.[50]

However, abolition of the Crown preference was accompanied by the fact that unsecured creditors by virtue of the creation of the unsecured creditors' lifeboat were given certain limited rights of priority over floating charges but not fixed charges. This 'ring-fenced' fund was introduced to offset the gain to floating charge holders caused by the abolition of the aforementioned preference. The arrangement provides that 20% of up to a maximum of £600,000 are set aside for unsecured creditors.[51]

Fifthly, an administrator may dispose of assets subject to a floating charge without the leave of court, but leave is required for the disposal of assets subject to a fixed charge. Furthermore, administrators and liquidators can pay their expenses out of assets subject to a floating charge[52] following the insertion of Section 176ZA of Companies Act 2006 in England, effectively reversing the case of *Leyland DafBuchler v. Talbot, Re Leyland Daf Ltd*[53] where the House of Lords held that floating charge assets constituted a separated fund, distinct from the company's own assets and as such, there was no priority for liquidation expenses over that of a floating charge. This places floating charge holders in a precarious scenario as the administrator may well trade at a loss and his expenses are likely to be substantial, potentially and greatly diminishing the value of assets secured by a floating charge.

It is therefore unsurprising that creditors show a preference for fixed charges over floating charges, seeing as there are real concerns as to the value of their security being obliterated in the event of the debtor's insolvency. It is therefore no doubt that due to the detrimental nature of the distinction, creditors have attempted to circumvent the natural rules related to the taking of security, the practices of which will be explored below. The major distinction between a floating charge and a fixed charge are: -

1. A fixed charge is a charge that is ascertainable on a specific property of the company and it is usually an immovable property of the Company while a floating charge is a charge on the whole or unspecified part of a Company's undertakings or assets.
2. A fixed charge can be either a legal or equitable charge but a floating charge is an equitable charge.
3. A fixed charge limits, to a great extent, the liberty of the Company to use the charged property in the ordinary course of its business with the knowledge and consent of the creditor while a floating charge gives the company the liberty to deal with the charged property even up to the extent of selling or leasing same as far as the interest of the floating charge is presented.

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[49] Enterprise Act 2002, s251; Insolvency Act 1986, ss 40 and 175. see also Insolvency Act, s 386 for categories of preferential creditors.

[50] Companies and Allied Matters Act, s 494 (1) (a)

[51] Re Permacell Finesse Limited (in liquidation) 2007, BDR 4792.

[52] Companies and Allied Matters Act, S.484

[53](2004) UKHL 9 In highlighting the distinguishing feature of floating charge, the Count held in Siebe Gorman and Co. Ltd v. Bardays Bank Ltd (1979) 2 Lioyd's Rep. 142 that a fixed charge has been created in favour of a bank over book debts because the absence of the Company's ability to use the book debts in the normal course of business deprived the charge of the character of being a floating one. Here the Company was required to pay the proceeds of the book debts into a account with the charge ban, which the company could not operate without the consent of the bank.

4. A fixed charge has priority over a pervious and subsequent floating charge. However, subject to Section 179 of CAMA, if the creditor has knowledge that such a charge was prohibited at the time the charge was granted to him.
5. A fixed charge has priority over a preferential debt while a floating charge is only satisfied after a preferential debt has been paid off.
6. A fixed charge does not crystallize into a floating charge but on the happening of some events, however a floating charge can crystallize into a fixed charge.
7. A fixed charge when created comes into immediate operation as the company is greatly restricted in freely dealing with the charged property without the creditor's knowledge and consent but a floating charge hovers/floats over the company's assets and does not affect the company using the assets as it likes since its effect is postponed till a future date.[54]

7. Similar Qualities of Floating and Fixed Charges and the Concept of Crystallization

Floating charges as well as fixed charges require due registration in line with the stipulations of CAMA particularly as provided in sections 190 – 201. Both must be further registered in the case of a mortgage at the Lands Registry where the property is situate. Similarly, fixed and floating charges are created over and in fact do affect or operate on the present and future undertakings or assets of the Company depending on the terms of the charge. In the same vein, being collateral for loans advanced to a corporate body, both floating and fixed charges rank in or have priority over unsecured creditors. Also, a fixed charge may convert into a floating charge where a Receiver or Manager earlier appointed over a crystallized floating charge is withdrawn from possession before the charge is fully or completely discharged. A floating charge can easily crystallize into a fixed charge. In addition, Receivers are necessarily appointed to protect creditors' interests once there is a total realization or sale of both floating and fixed charges. For floating charges, a Manager may be appointed too though a creditor may block such an appointment.

We have mentioned the term "crystallization" severally above. One may be wondering what it denotes. It simply describes the process of turning a floating charge into a fixed charge. This makes a floating charge child of equitable circumstance and the events that can occur for crystallization to take place are even statutory as provided in Section 178(1) & (2) of CAMA. Note that upon crystallization, all the assets of the company covered by the charge must be affected. Naturally, a floating charge does not provide for crystallization over only the assets to which it relates. Hence it has been pungently stated that

> ….. it is evident that crystallization is the transition stage of a floating charge, … which could be quite vulnerable in protecting a creditor's money, to a more reliable security of the fixed charge. However, this is not to say that a floating charge is not desirable in the creation of securities. The flexibility of a floating charge costs for the Creditor and the Company cannot be over emphasized because the company has more liberty in the normal course of its business and the Creditor, if he makes use of the negative pledge clause can also have his money well-secured over the Company's assets[55]

[54] Companies and Allied Matters Act, S.494
[55] See. S. 197(1) of CAMA, LNF, 2004.

Upon crystallization, no new security is created or brought into being. No fresh registration is required as no new charge has been willfully created by the company. Crystallization of a later floating charge would not crystallize an earlier one. Again, crystallization does not affect the priority of charges making earlier created charges rank higher to crystallized floating charges[56].

8. Book Debt and Its Controversy

The implications from the distinction above and the risk of being under-secured led banks and other commercial lenders to devise innovative ways and efforts to take fixed security over assets not conventionally suited for the fixed charge. One such asset is that of book debts. Book debts have been defined as ‘all such debts accruing in the ordinary course of a man’s trade as are usually entered in trade books but to constitute a book debt it is not necessary that the debt should be entered in a book.[57] In essence, book debts are uncollected debts owed to a company and the realized proceeds of such debts. These often form the largest asset owned by a company, whilst being perhaps the most undesirable for use as security.[58] This is due to the fact that the creditor would have to either retain significant control over the book debt or make regular enquires to ensure its volume remains the same as when it was created, rights of which are only consistent with that of a fixed charge. There is also no certainty that customers of the debtor will pay the debts on time, if at all.

The aim of lenders was to achieve an acceptable compromise between the level of control retained by the lender such that the debtor cannot freely dispose of them on one hand, and the freedom of the debtor to collect and utilize the proceeds of the book debts on the other. Although it was conceptually possible to create a fixed charge embodying this compromise over the present and future book debts of a company, the problems with doing so are manifest from the outset. Book debts are fluctuating assets. They are typical examples of assets possessing all three indicia in Romer LJ’s classic description of the floating charge in *Yorkshire Woolcombers*.

Indeed, it was in that case, which was later affirmed by the House of Lords in *Illingworth* that the concept of a fixed charge over debts generally was first considered. In *Yorkshire Woolcombers*, the debtor company assigned its present and future debts to trustees by way of security under a deed providing that the trustees could at any time require the company to give notice to the debtors and appoint a receiver. It also implicitly allowed the debtor to receive its debts and use its proceeds. The House of Lords unanimously held that the deed created a floating charge because it was the intention of the parties that the debtor should be able to deal with the debts and to dispose of them until the trustees intervened, deciding conclusively that if the debtor is free to use the proceeds of the debts, the charge will be a floating charge. The perplexing conundrum therefore was how much control over the debts was needed. In the series of cases attempting to resolve this problem to date, one general theme resonates: the status of a charge is determined not by the labels in the charge instrument, but by a question of characterization,[59] requiring a close examination of the charge instrument and the conduct of the parties in relation to it.

The matter laid dormant until banks crafted ways to give themselves sufficient control over the debts so as to make it a fixed charge. The lead was first taken by Barclays Bank in *Siebe*

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[56] Picardia, The Law Relating to the Receivers, Managers, and Administrators (2nd ed.)1990 pp. 36-39.
[57] Halsbury’s Laws (4th edn, 1989) vol. 3, para. 525.
[58] Wen yie Tan (n.29)p.18
[59] *Re Brumark Investments: Agnew v. Inland Revenue Commissioners* (2001) 2 AC 710 at 31-32

Gorman & Co v. Barclays Bank,[60] where a company granted a debenture in favour of Barclays Bank over all of its present and future book debts. The charge instrument required the debtor to pay the proceeds of the debts into an account with the bank and prohibited it from charging or assigning them in favour of any other party. Although there were no explicit restrictions on the use of the proceeds once they were paid into the account, Slade J in the Court of Appeal held that the charge was fixed as the bank had a right, if it chose, to block the company from making withdrawals and assert its lien under the charge on the proceeds. This was a landmark case where it was first declared that a fixed charge over book debts was possible, marking a significant departure from the orthodoxy of *Yorkshire Woolcombers*[61]. However, this approach drew criticism in that the bank's control was merely illusory and ephemeral, having never exercised the right in blocking the account. Nevertheless, following Siebe Gorman, banks and other commercial lenders adopted similar language in their standard charge instruments, with promising results, leading later courts to distinguish it where there were minute differences in wording[62]. These issues then came on appeal from the New Zealand Court of Appeal before the Privy Council *in Brumark*. In deciding on a charge virtually identical to that *in New Bullas*, the Privy Council was of the opinion that separating the two made no commercial sense and it is the extent of the debtor's right to use the proceeds which is determinative of the nature of the charge, affirming the basic approach articulated in *Brightlife* and overruling *New Bullas*. Lord Millett placed emphasis on the third indicia in Romer LJ's classification almost a century earlier, heralding it as the 'hallmark of a floating charge. His Lordship also adopted a two-stage test in determining a charge: (1) the court will construe the charge instrument and gather the intentions of the parties from the languages used to ascertain the nature of the rights and obligations intended; and (2) categorize it based on those rights.

The Privy Council also envisaged that restrictions on debt proceeds withdrawal must be real and substantial in practice and the account must operate as a blocked account, a stark contrast from the approach in *Siebe Gorman*. The Privy Council however regrettably left open the following issues, leaving the law in a state of uncertainty: (1) what would qualify as control (2) the level of post-collection control necessary; (3) whether *Siebe Gorman* was rightly decided; and (4) whether subsequent cases should follow *Brumark* or *New Bullas*.[63] Following this, creditors who could not rely on *Siebe Gorman* then purported to create a 'hybrid' charge to obtain the most effective security they can get, dividing debts into two separate assets to wit: (1) the receivable due from the debtor, secured by a fixed charge; and (2) the proceeds at the debtor's bank, secured by a floating charge. This controversial approach found favour with the Court of Appeal in *Re New Bullas Trading*,[64] and it gave the company the ability to deal with the proceeds while giving fixed security to the creditor, conceiving an effective compromise.

9. Spectrum Case Controversy: Equitable Elevation of the Floating Charge

Spectrum[65] was the final piece of the book debt puzzle, brought before seven Law Lords to examine the continued validity of *Siebe Gorman* following the decision of *Brumark*. Spectrum concerned a charge modeled on the *Siebe Gorman* charge. Similarly, there were no express restrictions from withdrawal sums once the proceeds were paid into the account. The only material difference was that the charge was given to secure an overdraft facility and the account

[60] 1979) 2 Lloyd's Rep. 142
[61] Wen yie Tan (n.29)p.18
[62] *Re Brightlife Ltd* 1987) Ch 200
[63] Wen yie Tan (n.29) p.25.
[64] (1994) 1 BCLC 485.
[65] *National Westminster Bank plc v Spectrum Plus Limited & ors*(2005) UKHL 41

as such, was always in debit. The issue was whether the charge was floating for purposes of the priority of payment of preferential creditors.

The House of Lords, unanimously overturning the decision of the Court of Appeal, decided that although the charge was expressed to be fixed, on true construction, it was a floating charge because the debtor remained free to use their proceeds in the ordinary course of business and this was the hallmark of the floating charge. Approving the result and reasoning of *Brumark*. *New Bullas* was held to be wrongly decided. Lord Scott, in delivering the leading speech, explained that where the chargor is free to deal with the charged assets or their proceeds without first obtaining the chargee's permission, the charge must be floating, the critical question being whether the chargor can draw on the account. He regarded that 'categorization depends upon the commercial nature and substance of the arrangement, not upon a formalistic analysis of how the bank clearing system works. 'Lord Scott also drew on Romer LJ's threefold characteristics in *Yorkshire Woolcombers,* as did Lord Millett in *Brumark*, stating that:

> The essential characteristic of a floating charge… is that the assets subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime, the chargor is left free to use the charged asset and to remove it from the security.

Lord Walker considered the distinction between fixed and floating charges. His Lordship expressed the view that for a fixed charge to be created over book debts, the charge must prohibit withdrawals from the account except with 'the active concurrence of the chargee'. His Lordship also approved Lord Millett's statement in *Brumark* that the provision in the charge instrument for a blocked account is not enough if it was not in fact operated as a blocked account.

Siebe Gorman was overruled with full retrospective effect based on an analysis fully consistent with *Brumark*. Lord Hope commented that it was 'not possible to defend the decision on any rational basis', drawing on the wider legal and commercial context that Slade J in *Siebe Gorman* had overlooked. The customer had without notice, a contractual right under the banker-customer relationship to freely operate the account within the limits of its overdraft, that relationship terminating only when notice was served and received. This right was 'wholly destructive of the argument that there was a fixed charge over the uncollected proceeds because the account into which the proceeds were to be paid was blocked".

The statements of Lords Scott and Walker suggest that a floating charge may be defined as a charge where the assets have not been permanently appropriated to the payment of the debt which the charge intends to secure. As earlier seen, even if the words of the charge instrument indicating a fixed charge are printed in red ink with a red hand pointing towards them, they are, without more, insufficient to create a fixed charge. The aim of Spectrum is admirable. It attempted to return a degree of certainly to the law on the distinction between fixed and floating charges. We wholeheartedly applaud and agree with the House of Lord's decision in Spectrum as it marked the triumph of the floating charge over fixed charge orchestrated by the saving grace of Equity.

10. Conclusion and Recommendations

In an era of financial instability, certainty is of great importance to banks and other commercial lenders. Agree that Spectrum has brought about a degree of certainty to the law governing floating and fixed charges distinction which has raged on for a very long period. The question whether Spectrum has laid this issue to rest will be answered in the future but as it stands today it is the law. Even as it stands today, so many commentators are criticizing this decision but this is rather not the focus of this discourse. We therefore encourage the use of floating and fixed charges. We say like Eyo that "an unsecured creditor has no standing in ensuring that his money comes back to him quite unlike a creditor who is covered either by a floating charge or a fixed charge. The existence of these charges makes a creditor confident that in the event of the company folding up, or the company trying to outsmart the creditor, the creditor has a fixed charge on the property of the company or that his floating charge could crystallize on the assets of the company and he (the creditor) will get his money back. Thus, fixed and floating charges encourage business between the creditor and the company[66]

[66]I A Eyo (n.35) p.37