AUTOMATIC REFLOATATION OF A CRYSTALLISED FLOATING CHARGE

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INTRODUCTION

Many of the floating charges which have been executed in recent times include what can be described as a "Refloatation" or "De-crystallisation" clause. A refloatation clause allows the chargee to decrystallise and refloat the fixed charge, usually upon the chargee giving written notice to the chargor that the asset or assets in question have been released from the operation of the fixed charge.[1]

Refloatation clauses have been included in floating charges to provide the chargee with scope to refloat its security. For instance, as part of a refinance undertaken by the chargee of the business of the chargor, the chargee may wish to refloat its existing security in respect of certain assets. The refloatation clause may also be beneficial to the chargor, enabling the floating charge to be refloated in relation to vital assets of the chargor.

This note examines whether or not, following crystallisation, a charge can be made to decrystallise and refloat *automatically*. Whilst the courts had some initial difficulty accepting the notion of automatic *crystallisation* of

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1. A *non*-automatic refloatation clause may take the following form:

   (a) Where an asset has become subject to a fixed charge under clause [ ], the Chargee may release the asset from that fixed charge by notice in writing to the Chargor.

   (b) When an asset is released from the fixed charge under clause (a), the asset will again be subject to:

      (1) the floating charge under clauses [ ] and [ ]; and

      (2) ....

floating charges, that concept now appears to be generally accepted.[2] But what of automatic *refloatation* of a crystallised charge?

Goode[3] points out that there is no authority on this point, but that in principle there can be no objection to the chargee restoring the management powers of the chargor company.[4] Deane[5] quite correctly points out that one reason for the paucity of authority in relation to this point is that cases where the chargee might want to refloat its charge automatically are rare.[6]

It is suggested that automatic refloatation of a crystallised charge may overcome one of the problems associated with the concept of automatic crystallisation, namely, that of the unnoticed crystallised charge.[7] By insertion of an appropriately worded clause into the contract of floating charge it may be possible to automatically refloat a crystallised floating charge if, for instance, no action is taken by the chargee within a specified time to enforce its security by appointing a receiver or entering into possession of the charged assets by its agent. In these circumstances, the charge would automatically refloat, allowing the chargor company to go about its usual business.

Most writers recognise that some form of contract entered into between the chargor and the chargee would be sufficient to refloat a crystallised charge.[8] Indeed, the refloatation clause set out in footnote 1 would be sufficient to refloat a crystallised floating charge, given an appropriate notice in writing by the chargee to the chargor. But that is not *automatic* refloatation because the clause contemplates some form of intervention by the chargee before the charge refloats.

It is contended that a charge can be made to refloat automatically. Automatic refloatation follows as a logical consequence of automatic crystallisation and recognises the overriding policy consideration of freedom of contract in this area.[9] However, it is all very well to conclude that automatic refloatation is conceptually and legally possible; but how can it be brought

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2. See, *Re Brightlife Ltd* [1986] 3 All ER 673; *Fire Nymph Products Ltd v Heating Centre Pty Ltd (in liq)* (1992) 10 ACLC 629 ("*Fire Nymph* case").
3. R M Goode *Legal Problems of Credit and Security* 2nd edn (London: Sweet & Maxwell, 1988).
4. Ibid, 75; see also P Blanchard *The Law of Company Receivership in Australia and New Zealand* (Sydney: Butterworths, 1982) 25.
5. R L Deane "Crystallisation of a Floating Charge" (1983) 1 CSLJ 185.
6. Ibid, 200.
7. J O'Donovan "Termination of Receiverships" [1979] Chartered Accountant of Australia (Sept) 47.
8. For example, Blanchard supra n 4, 25 and Dean supra n 5, 201.
9. See the comments of Gleeson CJ in *Fire Nymph* case supra n 2, 636 where his Honour discussed the notion of automatic crystallisation.

about?

RE-ASSIGNMENT OF THE CHARGEE'S INTEREST TO THE CHARGOR

The so-called contractual theory of floating charges, if correct, has the result that a floating charge gives rise to nothing more than an equitable chose in action in favour of the chargee.[10] The chargee's chose in action arises out of the contract of floating charge between the chargor and the chargee.

Crystallisation of the floating charge completes the equitable assignment by way of security and "perfects" the security interest of the chargee.[11] The security interest (which is a mere equity) enables the chargee, in equity, to enforce the contract of floating charge in accordance with its terms. After crystallisation of the floating charge the chargee possesses an equitable chose in action which is attached to the charged property to the extent permitted by the contract of floating charge. Since crystallisation is the perfection of the equitable assignment by way of security, before the charge can refloat there must be some re-assignment or detachment of the security interest from the charged property.

Because the interest of the chargee is equitable in nature, it can only be assigned or re-assigned in equity.[12] Generally there are no formal requirements for the assignment or re-assignment of an equitable interest. All that is required is a "clear expression of an intention to make an immediate disposition" of the equitable property in question.[13] Meagher, Gummow and Lehane[14] conclude that an equitable assignment does not have to purport to be an assignment; nor indeed need it use the language of assignment.[15] That conclusion is supported by the judgment of Lord Macnaughten in *William Brandt's Sons & Co v Dunlop Rubber Co Limited* where his Lordship held that:

> An equitable assignment ... may be addressed to the debtor. It may be couched in the language of command. It may be a courteous request. It may assume the form of permission. The language is immaterial if the meaning is plain.[16]

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10. Or, mere equity.
11. Blanchard supra n 4, 8.
12. A P Meagher, W M C Gummow and J R F Lehane *Equity, Doctrines and Remedies* 2nd edn (Sydney: Butterworths, 1984) 155.
13. *Norman v FCT* (1962-1963) 109 CLR 9, 30.
14. Supra n 12.
15. Ibid.
16. [1905] AC 454, 462.

It would therefore appear that the equitable chose in action of the chargee can be re-assigned and the charge automatically refloated by insertion of an appropriately worded clause to that effect in the contract of floating charge. The automatic refloatation clause should be drafted plainly to show the intention of the chargee to re-assign its interest in the circumstances outlined in the automatic refloatation clause.[17]

SECTION 20 PROPERTY LAW ACT[18]

Section 20 of the Western Australian Property Law Act (1969) ("PLA") sets out the manner in which certain choses in action can be assigned. The section has application to the assignment of "any debt or other *legal* chose in action". On a plain reading of these words it seems clear that section 20 would not encompass an interest in the nature of a mere equity obtained by a chargee once its charge had crystallised because that interest is equitable in nature. However, Australian authority gives a much wider interpretation to the meaning of the phrase in question. Section 20, so far as is relevant, provides that:

> Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal chose in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to receive or claim that debt or chose in action, is effectual in law (subject to equities having priority over the right of the assignee), to pass and transfer from the date of the notice:
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> (a) the legal right to that debt or chose in action;
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> (b) all legal and other remedies for the debt or chose in action; and
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> (c) the power to give a good discharge for the debt or chose in action, without the concurrence of the assignor.

As foreshadowed above, in Australia, the courts have construed the words "legal chose in action" to include equitable choses in action.[19] In *Everett's* case,[20] the High Court said of the interest of a partner in a partnership (which is equitable in nature), that it was assignable under the equivalent of section 20 because:

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17. It may be that the dismissal of the receiver appointed by the chargee manifests the requisite intention on the part of the chargee.
18. (NSW) Conveyancing Act 1919 s 12; (Qld) Property Law Act 1974 s 199; (Vic) Property Law Act 1958 s 134; (SA) Law of Property Act 1936 s 15; (Tas) Conveyancing and Law of Property Act 1884 s 86.
19. *FCT v Everett* (1979) 143 CLR 440 ("*Everett's* case").
20. Ibid.

> The interest, being a chose in action, falls within the expression 'debt or other legal chose in action' because the section, in providing that notice shall be given to a trustee 'as a person liable in respect of such a debt or other legal chose in action', appears to contemplate the assignment by a beneficiary of an equitable chose in action against the Trustee ... The expression 'legal chose in action' may be read as 'lawfully assignable chose in action'.[21]

If the requirements of section 20 are mandatory or, in other words, provide the only manner in which an equitable chose in action may be assigned, then before a charge can be refloated the requirements of the section must be fulfilled. On this assumption, automatic refloatation would not be possible because section 20 contemplates the assignment, and notice of the assignment, being in writing under the hand of the chargee. Clearly the requirements of writing and notice assume intervention and so preclude automatic refloatation of the charge.

However, it is strongly arguable that the requirements of section 20 are not mandatory in this respect. Meagher, Gummow and Lehane[22] contend that equitable choses in action are assignable apart from section 20 in the manner described under the second heading above, that is, by manifestation of a clear intention to assign the equitable chose in action.[23] In addition, Starke[24] suggests that provisions like section 20 do not supersede equitable assignments but merely provide an additional way of assigning choses in action.[25] The position with respect to equitable choses in action is to be contrasted with the assignment of legal choses in action because there is no means at common law to assign legal choses in action apart from section 20.

It is contended, therefore, that section 20 merely provides one way in which an equitable chose in action may be assigned. It does not provide the only way.[26] It follows that section 20 does not preclude automatic refloatation of a floating charge because the interest of the chargee can be re-assigned in equity in the manner contemplated by *Norman v FCT*.[27]

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21. Ibid, Barwick CJ, Stephen, Mason and Wilson JJ, 447.
22. Supra n 12.
23. Ibid.
24. J G Starke *Assignment of Choses in Action in Australia* (Sydney: Butterworths, 1972).
25. Ibid, 43.
26. Meagher, Gummow and Lehane supra n 12, 158.
27. Supra n 13. Interestingly, it may also be possible for the chargee to reassign part only of its security interest because it is only section 20 of the PLA which requires the assignment to be absolute.

SECTION 34(1)(c) PROPERTY LAW ACT[28]

Section 34(1)(c) of the PLA sets out the formal requirements for the disposition of equitable interests. This section may have the effect that the re-assignment of the security interest of the chargee[29] that would take place upon automatic refloatation of the charge must be "... in writing signed by the person disposing of the interest ...". If that were necessary then automatic refloatation could not occur because the chargee would be required to effect the refloatation by an instrument in writing.

Section 34(1)(c) provides that:

> A disposition of an equitable interest or trust subsisting at the time of the disposition shall be in writing signed by the person disposing of the interest, or by his agent thereunto lawfully authorised in writing or by will.

In *Adamson v Hayes*,[30] the High Court rejected the view that section 34(1)(c) only applied to the disposition of equitable interests in land.[31] The Court was of the opinion that section 34(1)(c) encompassed more than merely interests in land. The conclusion reached by the High Court was also adopted in a number of earlier English cases dealing with the equivalent of section 34(1)(c) under the United Kingdom Law of Property Act 1925.[32]

It is suggested that section 34(1)(c) is unlikely to apply in the situation where a charge is automatically refloated. This section clearly provides that it only applies to dispositions of "equitable interests". The chargee does not possess an equitable interest in the charged property by virtue of the floating charge even after crystallisation. The chargee possesses a mere equity only,[33] which upon crystallisation attaches to the assets the subject of the floating charge. That mere equity, whilst equitable in nature, is not an equitable interest.[34] In addition, the re-assignment associated with automatic refloatation is not an assignment which section 34(1)(c) was enacted to cover. It has been

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28. (Vic) Property Law Act 1958 s 53(1)(c); (NSW) Convenyancing Act 1919 ss 23C, 23D(1), 23E; (Qld) Property Law Act 1974 ss 11, 12; (SA) Law of Property Act 1936, ss 29, 30(1); (Tas) Conveyancing and Law of Property Act 1884 ss 60(2), (3), (5).
29. Which, it is contended, is a "subsisting interest" for the purposes of s34(1)(c) of the PLA.
30. (1973) 43 ALJR 201.
31. That view was taken by Menzies J ibid, 293.
32. For example *Grey v inland Revenue Commrs* [1960] AC1 where the House of Lords concluded that the equivalent of section 34(1)(c) of the PLA applied to the disposition of a beneficial interest in shares.
33. J O'Donovan *Company Receivers and Managers* 2nd edn (Sydney: Law Book Company, 1992) para [5.90].
34. See *Latec Investments Limited v Hotel Terrigal Pty Ltd* (1965) 113 CLR 265 Kitto J; *Phillips v Phillips* (1862) 45 ER 1164 Lord Westbury.

said that the purpose of section 34(1)(c) was to prevent hidden oral transactions in equitable interests.[35]

In any event, if section 34(1)(c) were to apply to the re-assignment which is attendant upon automatic refloatation, then it is likely that the automatic refloatation clause contained in the charge would satisfy the requirements of the section. Accordingly, section 34(1)(c) does not appear to prevent automatic refloatation of a charge.

CONSEQUENCES OF REFLOATATION ON REGISTRATION OF THE CHARGE

Section 263 of the Corporations Law provides, in part, that a notice in the prescribed form[36] must be lodged within 45 days after the creation of a charge. If that form is not lodged, the charge will be void against the liquidator of the company if the liquidator is appointed to the company within six months of the creation of the charge

The charge which is refloated under an automatic refloatation clause is the same charge. Refloatation (whether automatic or not) merely reinstates the security interest of the chargee and allows the chargor again to deal with the assets the subject of the floating charge in the ordinary course of business.[37] It follows that it is not necessary to re-register the refloated charge under section 263 because the refloated charge is not a new charge created on the property of the chargor company. Rather, it is, as Goode[38] points out, the same security interest that was originally created, became attached, and is now being detached once more from the assets of the company.[39]

It follows that upon refloatation of the charge, the charge maintains the priority conferred upon it by its initial registration under the Corporations Law.[40] It is conceded that automatic refloatation will potentially lead to the disruption of third party priorities without prejudice to the priority of the chargee which has the benefit of the automatic refloatation clause. However, that is not a reason to discount automatic refloatation. Similar problems exist with respect to automatic crystallisation and the courts have been willing not only to accept the notion of automatic crystallisation but also to recognise

35. Ford and Lee *Principles of the Law of Trusts* 2nd edn (Sydney: Law Book Company, 1990) 212, quoting *Vandervell v IRC* [1967] 2 AC 291, 311.
36. ASC Form 309.
37. Goode supra n 3, 75.
38. Ibid.
39. Ibid, 75.
40. Dean supra n 5, 201.

that, in some circumstances, automatic crystallisation may prejudice third party priorities. In the *Fire Nymph* case,[41] Chief Justice Gleeson stated, in connection with automatic refloatation, that:

> We are dealing with the operation of a contract, and there is nothing in legal theory that prevents parties from making a contract that might produce results adverse to third parties. In any event, the way in which third parties are affected will depend upon the rules as to priorities, often involving questions of notice, and those rules, generally speaking, operate in a fashion that gives practical effect ... to considerations of fairness.[42]

CONCLUSION

It is submitted that parties are free to provide in the contract of floating charge that the charge will automatically decrystallise and refloat upon the happening of certain specified events. Upon the happening of the events specified in the automatic refloatation clause the charge will refloat. Further, it is likely that the refloated charge will receive the benefit of the priority conferred on it by its initial registration under section 263 of the Corporations Law.

41. Supra n 2.
42. Ibid, 636.