

THE CONCEPT OF FLOATING CHARGE AND ITS PERFECTION IN BANGLADESH

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It is only a natural question for a creditor to ensure that he recovers his credit with agreed upon margin from the debtor. It is therefore no surprise that a creditor would attempt to obtain genuine rights over the debtor's properties for securing payment of the debt. As a result, any failure to repay would lead to the sale of the secured property for realizing the creditor's debt. Our law recognizes mortgage, pledge, lien/hypothecation, charges as modes of security. This article will mainly deal with the floating charge. Our case law on questions of fixed charges as security is settled, but does not deal with developments of floating charge very much. Keeping of title to goods until payment of the price i.e. hire purchase in general practice is intended as a security device, yet it does not constitute security as a matter of law. The seller/owner does not take security in the buyer's asset, he merely require that ownership to the buyer shall not devolve upon until the full price has been paid.

Kinds of security devices

(i) The mortgage

A mortgage is a transfer of an interest¹ in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan or, an existing or future debt.² Our law allows six kinds of Mortgages.³ *Simple* mortgages arise when without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage money, and agrees expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money.⁴ Where a mortgagor apparently or

1. Transfer of interest in a property is to be distinguished from transfer of ownership in a property. Transfer of ownership attracts a sale where all rights of the owner passes to the new purchaser. In a mortgage some rights are transferred to the mortgagee and certain important right always vest in the mortgagor.

2. Section 58 of the Transfer of Property Act 1882.

3. *Ibid*

4. *Ibid*

ostensibly sells the mortgage property on condition that on default of payment of the mortgage-money on a certain date the sale shall become absolute, or on condition that on such payment being made the sale shall become void, or on condition that such payment being made the buyer shall transfer the property to the seller, such transaction is called *mortgage by conditional sale*,⁵ provided that no such transaction shall be deemed to be a mortgage, unless the condition is embodied in the document which effects or purports to effect the sale. *Usufructuary mortgage* occurs where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and authorized him to retain such possession until payment of the mortgage-money and to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same in lieu of interest, or in payment of the mortgage-money, or partly in lieu of interest or partly in payment of the mortgage –money.⁶ Where a mortgagor binds himself to re-pay the mortgage money on a certain date and transfer the mortgage property absolutely to the mortgagee, but subject to a proviso that he will retransfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an *English mortgage*.⁷ Where a person delivers to a creditor or his agent documents of title to immovable property, with intent to create a security thereon, the transaction is called a *mortgage by deposit of title deeds*.⁸ A mortgage which is not a simple mortgage, a mortgage by conditional sale, a usufructuary mortgage, an English mortgage, or a mortgage by deposit of title deeds within the meaning of section 58 of the Transfer of Property Act is called an *anomalous mortgage*.

Advantage with mortgages is its suppleness. In commercial transactions with regard to security it is the most favorite vehicle of the financial institutions. Properties are and can be mortgaged without transferring possession by deposition of title deeds only. The mortgage thus is an instrument of utmost use in an environment where the financial institutions do depend at great length on securities like land having fixed value.

5. Ibid

6. Ibid

7. Ibid

8. Ibid – In Bangladesh, this was originally applicable only in the towns of Dhaka, Narayanganj and Chittagong and gave the power to the Government to include any other town by notification in the official Gazette.

(ii) The pledge

The Bailment⁹ of goods as security for payment of a debt or performance of promise is called a pledge.¹⁰ The bailor is called the "pawnor" The bailee is called the "Pawnee". Common law always emphasized on possession of a security. The policy evolved to restrict fraud upon the debtors. After delivery of possession the debtors were not able to provide security to other creditors on the basis of the same assets since the debtors would not have possession due to earlier pledge a sine qua non of a valid security interest. Even the mortgage of land was originally in the nature of a pledge, the mortgagee taking possession until payment, and it was not until the sixteenth century that the practice developed of leaving the mortgagor of land in possession.

Scope of the pledge further widened with the evolution of documentary ownership of goods or chattels. Only then it became unnecessary for the creditor to take or retain physical possession. Rather the constructive possession through a third party or even through the debtor himself became a recognized way to secure financing. This became particularly useful rule for banks financing the import of goods against a pledge of the shipping documents or pledge of share certificates¹¹ or railway receipts.¹²

Pledge's strength lies in the fact that though the pledgee's interest is a limited one, his possession gives him a legal title to that interest, with an implied power of sale in the event of default. The fact of possession indicates evidence of the transaction and also put third parties on notice of the pledgee's rights without any need for registration. However, it is inconvenient for the creditor like the banks to hold the assets of the debtor with other risks including risks of loss. Also if the assets are needed by the debtor in his business, for the purpose of generating income from which to pay the debt, a pledge to the creditor does not serve any purpose. Therefore, question of non-possessory security interest became a necessity.

9. Section 148 of the Contract act provides that "A 'bailment' is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the "bailor" and the person to whom they are delivered is called the "bailee".

10. Section 172 of the Contract Act 1872.

11. 1943 (Mad) 74

12. 1934 PC 246

(iii) The contractual lien

When a creditor is given right by contract to detain goods of the debtor to secure payment or performance of some other obligation, the goods having been delivered to the creditor for some purpose other than security, such as storage or repair a contractual lien is created. It is this element that separates the contractual lien from the pledge. The legal effect of a contractual lien differs from that of a pledge in that the pledge carries with it an implied power of sale upon the debtor's default, whereas a lien is in principle a right of detention only, so that a power of sale would have to be agreed between the parties.

(iv) Charges

Where immovable property of one person is by the act of parties or operation of law made security for the payment of money to another and the transaction does not amount to a mortgage, the later person is said to have a charge on the property.¹³ What constitutes a property may be an interesting question to answer at times. In *Abdur Razzak Howlader v Sh. Muhammad Shafi*¹⁴ Kaikaus J had to reply whether the rents and profits which are to accrue in future are properties or not? His Lordship stated that according to section 3(25) of the General Clauses Act and section 2(6) of the Registration Act benefits to arise out of immovable properties are immovable properties. This conclusion, his Lordship continues, receives support from the Privy Council decision of *M E Moolla Son Ltd. (In Liquidation) v Official Assignee of the High Court of Judicature at Rangoon and others*¹⁵ wherein the proposition appeared in that case to the effect that future rents in respect of land are benefits to arise out of the land was fully endorsed and a distinction was made between rent already accrued and rent to accrue in future. Rent already accrued it was held would not be immovable property for it was not a benefit to "arise out of land", but rent still to accrue was immovable property. It is necessary to explain here, however, that future rent payable by a lessee to whom the property has already been leased has two aspects and it is only one of its aspects that is to be regarded as immovable property. In one aspect it is the benefit which arises out of the use of land. In the other aspect however, it is merely a consideration of the transfer of rights in land. In a lease the lessor transfer an interest in the immovable property to the lessee and the rent is consideration for this transfer. A right to receive the consideration

13. Section 100 of the Transfer of Property Act 1882.

14. 14 DLR (SC) 119

15. 63 IA 340

for a lease is not immovable property any more than a right to receive consideration in the case of a mortgage or sale of immovable property. When property is given in mortgage against a sum of money there is a transfer of an interest in immovable property for a consideration as there is in the case of a lease but the amount received has never been regarded as a benefit arising out of land. Similarly observations would apply to a case where the property is sold outright. Although rent too is consideration for the transfer of an interest in land is regarded as a benefit to arise out of the land because it has another aspect. It is something which the owner on account of the use of the land. A charge does not involve the transfer either of possession or of ownership or any interest in property. It only creates the right of the creditor arising mostly out of a contract,¹⁶ to have an asset identified in the contract to be appropriated or sold to discharge the indebtedness in failure. In other words, an agreement or contract which gives immovable property as security for the satisfaction of a debt or for any other purpose without transferring any interest in the property constitutes a charge in the property. The right is satisfied from the sale proceeds of the asset. Such sale may result from the debtor's voluntary act or may occur under a court order for sale or the appointment of a receiver made on application of the chargee.¹⁷ Charges can be created in respect of movable or immovable properties. No specific form or writing is necessary to create a charge. It is sufficient to express the intention to make a particular property a security for payment of a debt. Section 100 of the Transfer of Properties Act deals with consensual charges¹⁸ and charges created by operation of law.¹⁹

The Floating Charge

For understanding commercial realities charges may be divided into fixed or floating. A fixed charge is one which fastens as soon as the

16. Sometimes by way of Trust

17. The broad distinction between a mortgage and a charge is this that whereas a charge only gives a right to payment out of a particular fund or particular property without transferring that fund or property, a mortgage is in essence a transfer of an interest in specific immovable property (mortgage of movable property not considered for the purpose of this article). A mortgage is a *jus in rem*, a charge *jus ad rem* and the practical distinction is that a mortgage is good against subsequent transferees and a charge is only good against subsequent transferees with notice. Per Das J. in *Raja Sri Shiva Prasad v Beni Madhab* AIR 1922 Pat 529.

18. Charges created by act of parties.

19. Application of sections 39, 55(4)(b), 55(6)(b), 72, 73, 95 of the Transfer of Property Act 1882 creates charges by operation of law.

charge has been created or the debtor has acquired rights in the asset to be charged, whichever is the later. The result is that the debtor cannot dispose of the asset free from the charge without the chargee's consent except, by satisfying the indebtedness secured by the charge. The floating charge is one which flies over a designated class of assets in which the debtor has or will acquire any interest in future. The debtor in such case is free to deal with the properties so charged with floating charges so long no default event occurs which crystallizes²⁰ the floating charge.²¹ Therefore, the creditor in a floating charge will have interest in the continuing or revolving assets of the debtor instead of any particular assets. It is a present charge in a company's asset although it does not attach or crystallize upon any specific property until the happening of some event which puts an end to the right of the company to deal with the property in the course of business. A creditor can take a fixed and floating charge over the same asset to secure different liabilities but not the same liability.

The lenders in whatever jurisdiction is not usually comfortable in advancing money without any security. In case of a commercial enterprise or a company its most important and valuable assets are its equipment and receivables. However, in order to transfer any security interest in the equipment, it had to be an existing one. Unless a property existed it could not be used for security. In common law if one wanted to finance any new equipment in substitution of old ones, a new instrument of transfer had to be written to specify the security pursuant to the original security document which would specify such future event of substitution the equipment. In *Holroyd v. Marshall*²² it was held that equity would

20. Explained below.

21. In other words the floating charge is an interest in corporate property granted to a lender, generally a debenture-holder, which attaches or "crystallizes" on the happening of certain defined events such as (i) the company going into liquidation (this is an event that itself crystallizes a floating charge), (ii) the appointment of an administrative receiver (iii) the levy of execution or distress on the assets of the company (iv) the company becoming unable to pay its debts (v) cessation of business by the company (vi) the giving of notice by the chargee converting the charge into a fixed charge, if agreed upon in the document creating the charge for such notice. Prior to crystallization, the company is free to deal with the property subject to the charge in the ordinary course of business. Once the charge crystallizes, it becomes a fixed charge. Subject to the provisions of the debenture, the charge generally crystallizes on the liquidation of the company, or on the debenture-holders taking possession of the property charged or appointing a receiver. – (LAW REFORM COMMISSION OF BRITISH COLUMBIA)

22. (1862) 10 HL cas 191.

recognize a charge over after-acquired property. Such charge over future property would be effective to create a security interest attaching automatically on acquisition without the need for a new act.

Holroyd v. Marshall dealt with an equitable mortgage of machinery in a mill. The mortgagor in this case was required to hold the machineries for the mortgagee with independence to substitute new machineries which would then become subject to the charge. It was held that the mortgage was effective even over the after-acquired or newly substituted machineries purchased in replacement for the original equipment. This provided effectively for security over machinery and other equipment. However with a device as such the debtor could not dispose of its secured properties without authorization by the mortgage or without the creditor's consequent approval. Therefore, the difficulty of security over changing or variable classes of assets like stock and receivables remained. It was impractical to ask a trading company to ask permission of its mortgagee every time it wanted to sell an item or ask permission of its mortgagee every time it wanted to sell an item of stock. In case of receivables it is only natural that the debtor would want to pay the proceeds of sale into its own bank account. Although the obligation to pay the mortgagee remains the debtor would normally want to treat all its receivable as its own money and pay the mortgagee at its own will without segregating its sale proceeds to identify any specific amount for the benefit of the mortgagee. To get to an answer for such problems the floating charge was the only reply.

This concept of floating charge originated in England in a series of cases in the Chancery Division in the 1870's.²³ Two things led to this development. First, the possibility of assigning future property in equity was confirmed in *Holroyd v Marshall* as stated earlier. The principle was of general application and made it possible for future book debts to be assigned by way of security.²⁴ Secondly, the Companies Clauses Consolidation Act 1845 sanctioned a form of mortgage for use by statutory companies by which the company assigned "its undertaking". This formula was afterwards adopted by companies incorporated under the Companies Act 1862.

23. *In re Panama, New Zealand, and Australian Royal Mail Co* (1870) 5 Ch App 31824 ; *In re Florence Land and Public Works Co, Ex p. Moor* (1878) 10 Ch D 530; *In re Hamilton's Windsor Ironworks Co., Ex p. Pitman & Edwards* (1879) 12 Ch D 707; and *In re Colonial Trusts Corporation, Ex p. Bradshaw* (1879) 15 Ch D 465

24. *Tailby v Official Receiver* (1888) 13 App Case 523

*In re Panama, New Zealand, and Australian Royal Mail Co*²⁵ the debenture issued was in this form. The debenture was issued charging "the undertaking" of the company "and all sums of money arising therefrom". This was taken to mean all the assets of the company both present and future including its circulating assets, that is to say, assets which are regularly transacted in the course of trade. From the word "undertaking" Giffard LJ derived the inference that unless and until the charge holder intervened the parties contemplated that the company was to be at liberty to carry on business as freely as if the charge did not exist, which it would not be able to do if the circulating assets were subject to a fixed charge. The thinking behind the development of the floating charge it seems was that compliance with the terms of a fixed charge on the company's circulating capital would paralyze its business. This theme was repeated in many of the cases.²⁶ A fixed charge gives the holder of the charge an immediate proprietary interest in the assets subject to the charge which binds all those into whose hands the assets may come with notice of the charge. Unless it obtained the consent of the holder of the charge, therefore, the company would be unable to deal with its assets without committing a breach of the terms of the charge. It could not give its customers a good title to the goods it sold to them, or make any use of the money they paid for the goods. It could not use such money or the money in its bank account to buy more goods or meet its other commitments. It could not use borrowed money either, not even, as Sir George Jessel MR observed, the money advanced to it by the charge holder. In short, a fixed charge would deprive the company of access to its cash flow, which is the life saving oxygen of a business. Where, therefore, the parties contemplated that the company would continue to carry on business despite the existence of the charge; they must be taken to have agreed on a form of charge which did not possess the ordinary incidents of a fixed charge. The floating charge is capable of affording the creditor, by a single instrument, an effective and all-embracing security upon the entire undertaking of the debtor company and its assets from time to time, while at the same time leaving the company free to deal with its assets and pay its trade creditors in the ordinary course of business without reference to the holder of the charge. Such a form of security is

25. *Supra* 21.

26. *In re Florence Land and Public Works Co.* at p. 541 *per* Sir George Jessel MR; *Biggerstaff v Rowatt's Wharf Ltd.* [1896] 2 Ch 93, at p.101 *per* Lindley LJ and p. 103 *per* Lopes LJ

particularly attractive to banks, and it rapidly acquired an importance in commercial life²⁷ of enterprises.

The nature of the floating charge

Lord Macnaghten provided the first judicial definition of a floating charge in *Governments Stock and Other Securities Investment Co Ltd v Manila Railway Co.*:²⁸

“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 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.”

However, the most celebrated, and certainly the most often cited, description of a floating charge is that given by Romer LJ in *In re Yorkshire Woolcombers Association Ltd.*:²⁹

“I certainly do not intend to attempt to give an exact definition of the term “floating charge,” nor am I prepared to say that there will not be a floating charge within the meaning of the Act, which does not contain all the three characteristics that I am about to mention, but I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1.) If it is a charge on a class of assets of a company present and future; (2.) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3.) if you find that by the Charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with.”

This was offered as a description and not a definition. The first two characteristics are typical of a floating charge but they are not wholly distinctive of it, since they are not necessarily inconsistent with a fixed charge. It is the third characteristic which is the hallmark of a floating charge and serves to distinguish it from a fixed charge. Since the existence of a fixed charge would make it impossible for the company to carry on business in the ordinary way without the consent of the charge holder, it follows that its ability to do so without such consent is

27. [2001] UKPC 28 – The Court of Appeal of New Zealand

28. [1897] AC 81, at p. 86

29. [1903] 2 Ch D 284 at p.295

inconsistent with the fixed nature of the charge. In the same case Vaughan Williams LJ explained at p. 294: "... but what you do require to make a specific security is that the security whenever it has once come into existence, and been identified or appropriated as a security, *shall never thereafter at the will of the mortgagor cease to be a security. If at the will of the mortgagor he can dispose of it and prevent its being any longer a security, although something else may be substituted more or less for it, that is not a "specific security"* (emphasis added).

This was the first case to deal specifically with book debts. The question was whether a charge on uncollected book debts was a fixed charge or a floating charge so as to require registration. At every level of decision it was held to be a floating charge, the critical factor being the company's freedom to receive the book debts for its own account and deal with the proceeds without reference to the charge holder.

At first instance³⁰ Farwell J said at p. 288: "If the assignment is to be treated as a specific mortgage or charge or disposition, then the company had no business to receive one single book debt after the date of it; but if, on the other hand, although not so called, *the company was intended to go on receiving the book debts and to use them for the purpose of carrying on its business*, then it contains the true elements of a floating security" (emphasis added).

And at p. 289: "A charge on all book debts which may now be, or at any time hereafter become charged or assigned, leaving the mortgagor or assignor free to deal with them as he pleases until the mortgagee or assignee intervenes, is not a specific charge, and cannot be. The very essence of a specific charge is that the assignee takes possession, and is the person entitled to receive the book debts at once. So long as he licenses the mortgagor to *go on receiving the book debts* and carry on the business, it is within the exact definition of a floating security" (emphasis added).

Cozens-Hardy LJ in appeals also at p. 297 spoke in similar terms along with Romer LJ expressly treating the company's right to go on *receiving* the book debts as inconsistent with the nature of a fixed charge.

When the case reached the House of Lords³¹ Lord Halsbury LC also took this to be the critical factor at p. 357: "It contemplates not only that it should carry with it the book debts which were then existing, but it contemplates also the possibility of *those book debts being extinguished by*

30. *Ibid*

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

payment to the company, and that other book debts should come in and take the place of those that had disappeared. That, my Lords, seems to me to be an essential characteristic of what is properly called a floating security. The recitals ... shew an intention on the part of both parties that the business of the company shall continue to be carried on in the ordinary way - that the book debts shall be at the command of, and for the purpose of being used by, the company. Of course, if there was an absolute assignment of them which fixed the property in them, the company would have no right to touch them at all. The minute after the execution of such an assignment they would have no more interest in them, and would not be allowed to touch them, whereas as a matter of fact it seems to me that the whole purport of this instrument is to enable the company to carry on its business in the ordinary way, to receive the book debts that were due to them, to incur new debts, and to carry on their business exactly as if this deed had not been executed at all. That is what we mean by a floating security." (emphasis added).

The language of Romer LJ was endorsed by Lord Macnaghten on appeal:³² "I should have thought there was not much difficulty in defining what a floating charge is in contrast to what is called a specific charge. A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is mended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

Therefore, the fundamental concept is that of a class of circling or revolving assets which the company is to be free to manage and deal with in the ordinary course of business until an event occurs which entitles the creditor to intrude and assert his security and assert his security rights over the assets then held or subsequently acquired by the company. The occasion of such an event is said to cause the charge to 'crystallize'. Until crystallization, the security interest does not attach and the charges has merely an interest in a liquid fund of assets. As to the existence of a floating charge Buckley LJ in *Fovans v. Eival Granite Quarries Ltd.*³³ stated that; "A floating charge is not future security; it is a present security, which presently affects all the assets of the company expressed to be included in it. A floating security is not a specific mortgage of the assets, plus a license to the mortgagor to dispose of them in the course of his

32. *Ibid* at page 358

33. [1910] 2 KB 979

business, but is a floating mortgage applying to every item comprised in the security but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize into a fixed security.”

As a result, a floating charge forms an instantaneous security interest but until crystallization no specific asset is appropriated to the security. The debtor company is free to deal with the asset in the ordinary course of its business. In comparison to a fixed charge, the debtor company’s present ownership or subsequent acquisition of property covered by the floating charge is not sufficient to cause the security interest to attach; a further act is needed to cause the charge to crystallize.

When crystallization takes place, the fund of assets comprised in the charge freezes, terminating the debtor company’s powers to manage to the assets and converting the creditor’s security interest into a fixed interest as regards the property covered by the charge in which the company then has or subsequently acquires an interest. Although the floating charge is naturally taken over property not prone to a fixed charge, it is not limited to moving or rolling assets but can be made to cover any description of property, including land. On the other hand, it is possible to have a fixed charge over revolving assets. In application however, because of the advantages of a fixed charge in the event of the debtor’s liquidation, creditors tend to take a fixed charge over fixed assets and a floating charge merely over circulating assets. The main test for distinguishing between a fixed and a floating charge is not whether the assets comprising the security are fixed or circulating but whether the creditor has or has not excluded the debtor’s right to continue of business free from charge.³⁴ Having said so, a charge over circulating assets is intended as a floating charge, so that restrictions on the debtor company’s ordinary dealing authority with its assets remain intact, whereas in case a charge over fixed assets is wished to dispose of the asset free from the charge, it would need to obtain the charge’s assent.

Creation of the charge

To create a floating charge no particular form of words is necessary. It is sufficient that the agreement expresses an intention to charge the company’s present and future assets, or a designated class of assets, with freedom to deal with them in the ordinary course of business and the creditor does not exercise any right to interfere. However, for it is normally created by an instrument expressed to cover the debtor company’s ‘undertaking’ or its present and future property’. The

34. *Sieve Gorman & Co. Ltd v. Barclays Bank Ltd*,

important issue is to examine the nature of the charge or the nature of the overall transactions despite characteristics dedicated to such charges by expressions in instruments. It is almost immaterial or of no consequence how the document describes a security i.e. fixed or floating charge. The courts are to look at the essence of the transaction.

What causes crystallization of a floating charge?

Even with the existence of floating charges the company will continue to have authority and manage its business with its directors performing. Crystallization occurs through the withdrawal of the authority of the company to continue management of the assets comprised in the security. It may be mentioned here that the withdrawal of the company's authority may be actual or apparent. These two types of withdrawal of authority need to be distinguished. In case if the directors' powers of management relinquishes with regard to part of the assets comprised in the floating charge, as regards the remainder of such assets, the charge prolong to float.

(i) Apparent withdrawal : The floating charge will crystallize if the company stops to do or continue its business either voluntarily or in response to a winding-up petition or other external cause. Although for practical purposes a receiver is appointed formally the directors preserve power to manage the affairs of the company, such theoretical control does not prevent crystallization.

(ii) Actual withdrawal : When the company is in fact transacting, termination of the power of the directors to run the company as a running business will cause the charge to crystallize i.e. crystallization will commence or occur from the appointment of a receiver (voluntarily, by other secured creditors or by the court), passing of a resolution for voluntary winding up, the making of a winding-up order.

(iii) Chargee's exercise of intervention : When the chargee has become entitled to intervene in the management of the company's power thereby stripping the directors of their own powers to manage in relation to the charged assets, the charge will crystallize. Normal manner of intervention includes (but is in no way limited to) the appointment of a receiver, sending of notice to crystallize under any instrument (i.e. debenture) to take possession of the assets, sale of assets. What entitles a chargee to intervene and terminate a company's management powers may be stipulated by an agreement between the parties i.e. as between the chargee and the company. Subject to a clear clause in this regard, a demand for arrears payment to the company or its bankers does not of itself cause crystallization.

(iv) Automatic and partial crystallization : The freedom to incorporate

commercial covenant in a commercial contract is inherent and is quite common in borrowing agreement. It is often the case that auto crystallization is incorporated in such contracts with an event of default³⁵ clause of various characters. Few examples will make the case easier; if the debtor company allows its corporate borrowing to surpass a certain amount, fails to pay a sum due under the charge within a specified period of time, allows a judgment against it by any third creditor etc. may result in crystallization.³⁶ All such events may occur without any notice to third parties or without the instance of the creditor.

A floating charge may provide for crystallization over part of the assets keeping aside the charge floating as to the remainder. However a condition precedent for such a partial floating charge is that the subject of the partial crystallization has to be distinctly identifiable from the security agreement.

Effect of crystallization

Crystallization results in the charge becoming a specific charge over any property in which the company has or later gain an interest. The chargee acquires all the rights of the holder of a specific equitable charge on the assets of the company and the company's actual authority to deal with the charged assets comes to an end. The remedies given at law are extended or written in the instrument forming the charge. As stated earlier normally, the chargee will be able to appoint a receiver, to take possession, to sell the assets or take other steps. Questions of priority of the creditors will also arise when crystallization arises by reason of the appointment of a receiver or because the company goes into liquidation. The question of validity of the charge may also become an issue at this stage e.g. failing to apply statutory requirement,³⁷ creating the charge at a time when it was illegal to do so.³⁸

Priorities

(i) Interests occurring prior to crystallization: The creation of a mortgage or fixed charge after a floating charge has been created will still take

35. Although it does not necessarily have to be an event of default. What is important is to identify the crystallization event.

36. In *Re Breghtlife Ltd.* (1987) Ch 200, Hoffman J. referred to the distinction between crystallization by action of the chargee (as in the case before him) and 'automatic' crystallization without the chargee's knowledge. His lordship expressed the view that the courts should not limit the freedom to contract by refusing to give effect to automatic crystallization clauses.

37. Section 159 of the Companies Act 1994.

38. E.g. when the company is insolvent.

priority over the floating charge since in case of a floating charge the company is free to deal with its assets in the ordinary course of business. This is because of the nature of the floating charge. However, if a subsequent floating charge is created on the assets which are already subject to earlier floating charge, express ranking in priority to the junior or later floating charge is prima facie against the intention of the earlier charge. Even if the later floating charge crystallizes first, it is useless against the holder of the earlier charge except in so far as thereby authorized. It may be noted that any creation of later fixed charges ranking in priority to the floating charge normally is restricted by the terms of the instrument of charge. Such restrictions will not bind a subsequent purchaser or encumbrancer unless he has notice of them but are successful as between the chargee and the company but.

(ii) Interests arising after crystallization : The parties in a floating charge are free to agree on any event they choose as constituting a crystallizing event as stated earlier. Such events may not be known to any third party and before such event arises the company is free to deal with the assets. But although crystallization terminates the company's authority to dispose of the asset, its power to do so still remains. This depends on the extent to which its apparent authority continues. In principle, a person who dealt with the company prior to crystallization should be entitled to assume the continuance of its authority to deal until he has had notice of the termination of that authority. Similarly, one who dealt with the company for the first time after crystallization and was aware of the existence of the floating charge but not of its crystallization can reasonably contend that the company was held out to him as continuing to have authority to deal. It is one of the mysteries of the development of this branch of law that priority conflicts between the holder of a crystallized charge and a third party claiming rights over the charged property have always been viewed in purely property law terms, without reference to agency principles, and the issue has thus been to consider if the holder of the charge's interest or that of the rival claimant's interest was created first. However, the priority of the first in time is not definite rule. He may lose it if he allows the debtor to hold himself out to be at liberty to deal with the asset free from the security. Where the crystallizing event is itself a public act, the termination of apparent authority will coincide with the time of crystallization. Therefore, the holder of the crystallized charge will have priority over a subsequently created interest. This is the case when the crystallizing even is the winding up of the company or the cessation of its trading activity. But not all crystallizing events are of this character. The appointment of a receiver or taking possession of property by the

charger has to be notified otherwise would not be able to defeat the claims of the bonafide purchaser for value.

Perfecting floating charges in Bangladesh

Only certain forms of non-real estate security are required to be registered. It is to be understood that floating security or charge is recognized regarding limited companies in as much the same terms as in England.³⁹ Therefore what has been stated above on the nature and character of the floating charges in Common law is applicable in Bangladesh as well. Charges on company assets including floating charges must be recorded in the Registry of Joint Stock Companies (JSC). Pledges and hypothecations as such do not need to be recorded. Encumbrances against assets of sole proprietorships are apparently not registered at all. Laws on companies and registration make registered instruments effective as of the date of their execution, not of registration itself. The possibility of conveyances in the interim introduces uncertainty. Priorities among creditors can therefore be uncertain, and are not moreover widely known. In practice priorities are determined by either usage or agreement.

The relevant provisions and comments

Section 159 of the Company Act 1994 provides for the registration of the floating charges.⁴⁰ The validity of a charge under the section does not

39. AIR 1935 Cal. 218-62 Cal. 1 (DB)

40. *Certain mortgages and charges to be void if not registered.* Every mortgage or charge created after the commencement of this Act by a company and being either-

- (a) mortgage or charge for purpose of securing any issue of debenture; or
- (b) a mortgage or charge on uncalled share capital of the company; or
- (c) a mortgage or charge on any immovable property wherever situate, or any interest therein; or
- (d) a mortgage or charge on any book debts of the company; or
- (e) a mortgage or a charge, not being a pledge on any . movable property of the company except stock-in-trade; or
- (f) **a floating charge on the undertaking or property of the company;**

shall, so far as any security on company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the company, unless the prescribed particulars of the mortgage or charge, together with the instrument (if any) by which the mortgage or charge is created or evidenced, or a copy thereof verified in the prescribed manner are filed with the registrar for registration in manner required by this Act within twenty-one days after the date of its creation, but without prejudice to any contract or obligation for repayment of the money thereby secured, and when a mortgage or charge becomes void under this section. this money secured thereby shall immediately become payable:

Provided that-

stand only on the actual registration of it by the Registrar. No precise form is required by the company for creating a charge or a mortgage whether on immovable property or movable property and if the intention of the parties to create a charge is clear from the transaction, it is sufficient for the purpose of this section.⁴¹ A floating charge regarding immovable properties of a company is to be registered both under the Registration Act and also under this section of the Companies Act.⁴² As understood from the nature of a floating charge that such charge may become specific on the happening of one of the events mentioned in the conditions of the debenture, the issue of debentures is a mutation of the right of the company to its immovable property contingent on one of the events specified in the condition. Further issuance of a debenture does denote to create a charge as described in section 100⁴³ of the Transfer of Property

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- (i) in the case of a mortgage or charge created out of Bangladesh comprising solely property situate outside Bangladesh twenty-one days after the date on which the instrument or copy could, in due course of post, and if dispatched with due diligence, have been received in Bangladesh shall be substituted for twenty-one days after the date of the creation of the mortgage or charge as the time within which the particulars and instrument or copy are to be filed with the registrar; and
 - (ii) where the mortgage or charge is created in Bangladesh but comprises property outside Bangladesh, the instrument creating or purporting to create the mortgage or charge or a copy thereof verified in the prescribed manner may be filed for registration notwithstanding that further proceedings may be necessary to make the mortgage or charge valid or effectual according to the law of the country in which the property is situate; and
 - (iii) where a negotiable instrument has been given to secure the payment of any book debts of a company, the deposit of the instrument for the purpose of securing an advance to the company shall not for the purposes of this section be treated as a mortgage or charge on those book debts; and
 - (iv) the holding of debentures entitling the holder to a charge on immovable property shall not be deemed to be an interest in immovable property.
- (2) Where any mortgage or charge on any property of a company required to be registered under this section has been so registered, any person acquiring such property or any part thereof, or any share or interest therein, shall be deemed to have notice of the said mortgage or charge as from the date of such registration.
41. AIR 1955 Bom. 419
 42. AIR 1957 Mad 169 (DB)
 43. Where immovable property of one person is by act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property...

Act on the property of the company. As the provisions of section 17 (I) (b) of the Registration Act⁴⁴ purport or operate to create, declare, assign, limit or extinguish a right, title or interest are mandatory; debentures which are not registered under that section fail to create a charge on the immovable property of the company.⁴⁵ A debenture which contained no stipulation to qualify the elasticity of the floating charge and which left the company at liberty to execute specific mortgages or charges in priority to it, was held to require registration under section 17 of the Registration Act and that in the absence of such registration it could not take effect with regard to the immovable property of all sorts possessed by the company at the time of its execution. The fact that the right of the company to use the property during the course of its business was a condition of the charge was no reason to exempt the instrument from compulsory registration under the Registration Act.⁴⁶ However, as apparent from the fourth proviso to section 159 (I)⁴⁷ would exempt only the debentures from being registered and not the immovable properties given as security to the debenture holders. A floating charge creates an immediate equitable charge on the assets, subject to the right of the company in the ordinary course and for the purposes of its business, but not otherwise, to dispose of the assets as if the charge did not exist.⁴⁸ A floating charge does not prevent the making of a specific charges or specific alienations of property by the company because that would destroy the very object for which the money is borrowed, namely the carrying on of the business of the company. Thus where under the power conferred on it by the articles to borrow money by mortgage or by "bonds, debentures or mortgage debentures" under which the holders would be entitled to be paid out of the moneys, property and effects of the company and similarly the company issued *pari passu* instruments binding themselves and their estates to repay at a future date and with a power to redeem a certain part of the liability at intermediate dates; it was held that it constituted a charge on the property subject however, to the right of the company to dispose of any part in the ordinary course of its business.⁴⁹ Because of the nature of a floating charge where a deed of debenture after charging all the assets of the company by way of a

44. Covering the registration of non-testamentary instruments

45. AIR 1959 All 247

46. AIR 1913 Cal. 223=Cal. 136 (DB)

47. *Supra* 37.

48. AIR 1957 Mad. 169 (DB)

49. (1878) 10 Ch. D 530

floating charge provides that notwithstanding such charge the company should have power to carry on the business and deal with the assets until the happening of a certain event, the right to carry on the business is not infringed automatically by the happening of the event but continues until the debenture-holder intervenes to show his desire that it should cease.⁵⁰ However, any debt incurred by the company in the ordinary course of carrying on its business after the creation of a floating charge are capable of being realized by the creditor through the process of law, before the floating charge is crystallized. The person in whose favor a floating charge has been created may intervene at any time only after default. A debenture holder may obtain the appointment of a receiver or receiver and manager and crystallize the floating charge. When the floating charge upon all the property or assets of the company is so crystallized or fixed, it constitutes a charge upon all the property or assets then belonging to the company. A floating security which has been crystallized has priority over subsequent equitable charges and over unsecured creditors and over moneys advanced to the liquidator to carry on the business of the company although the advances were made with the sanction of the court in winding up and over the costs of the liquidators other than costs of realization. The right of the creditor holding a floating charge to intervene on default may be suspended by agreement and if the company creates mortgages and charges subsequent to the suspension of the power the question of their priority is a question of construction. Such an agreement can also contain a power to create a second floating charge ranking in priority.

Section 160 of the Companies Act 1994 provides for registration of charges on properties acquired subject to charge. It is a self explanatory provision and reads as follows:

(1) Where a company registered in Bangladesh acquires any property which is subject to a charge of any such kind as would, if it had been created by the company after the acquisition of the property, have been required to be registered under this Part, the company shall cause the prescribed particulars of the charge, together with a copy certified in the prescribed manner to be a correct copy of the instrument, if any, by which the charge was created or [is] evidenced, to be delivered to the registrar for registration in manner required by this Act within twenty-one days after the date on which the acquisition is completed.

50. AIR 1917 Mad. 646

Provided that, if the property is situate and the charge was created outside Bangladesh the said twenty-one days shall be counted by excluding the period which would be necessary to receive the instrument in Bangladesh in due course of post had it been dispatched with due diligence.

(2) If default is made in complying with this section, the company and every officer of the company who is knowingly and willfully in default shall be liable to a fine not exceeding one thousand taka.

Procedure for registration

Charges, are somewhat easier to register. Fees are modest: about 600 tk for a loan up to one crore (ten million equals one crore), then 400 tk for each subsequent crore. The registration process is as follows:

- (i) the creditor financial institution sends a "sanction" letter through the borrowing firm, stating the items to be charged, with the registration fee;
- (ii) before registering the charge, the registry checks for any title problems, encumbrances, unpaid rent, or other problems with the property to be charged;
- (iii) the registry checks whether the agreement to charge the property was approved by a duly constituted meeting of the company board of directors, and if necessary checks the company's articles of association;
- (iv) if necessary, the registry checks whether any outstanding taxes are due on the property; and
- (v) the registry issues a registration certificate to the company.

Registration normally can be done within a week or even three to four days. Companies are required to register charges within 21 days, although delays can be obtained with permission from the High Court. Companies whose charges are subject to registration include corporations and partnerships, but not sole proprietorships or cooperatives. Most commercial loans are extended by banks without registration of a charge. A bank can check prior charges upon payment of a 20 tk fee. The Companies Act, 1994 requires the JSC Registry to keep indexes both by company and chronologically,⁵¹ although the Registry appears to operate without written administrative rules.

51. Articles 163 and 164

However, with respect to both mortgages and company charges, registration may fail to play its optional role as a system of "perfection" or creation of legally effective interests entitles to protection against third parties. The problem here is that even when registration is required for legal effectiveness, this legal protection does not begin on the date of registration but relates back to the date on which the subject agreement was created. Time lags of 21 or even 30 days permitted between creation and perfection mean that, for such period of time, third parties have no notice of prior security interests. This introduces significant uncertainty into the scheme of security interest priorities. Furthermore, the registries are called upon to perform the kind of due diligence that is best left to interested parties. This explains much of the system's ineffectiveness. At least with respect to non-real estate security, this system would be much clearer and efficient if the registries were limited to the mechanical task of posting notices of asset encumbrances, and running searches of these notices, without having to ensure the legal validity of the encumbrances.

In conclusion it must be said that the purpose of this article was only to provide a glimpse on the floating charges. Although this device is in practice by the commercial banks and other financial set-ups, case law on this subject is scarce. One reason may be the fact that in practice the banks in Bangladesh would always take security with real assets and personal and corporate guarantees in addition to floating charges on the revolving assets. And in almost all cases they are able to realize their debt through the sale of the real assets. Furthermore, junior credits are also very unpopular and thus junior security is also quite uncommon. Normally a later creditor would always ask for a *pari passu* clause and bring the earlier creditor in the scene and enter into a new agreement of credit. Hence the development of floating charge is slow in our jurisdiction. However, with more commercial activities it is expected that because of the flexible nature of the floating charge, and its frequent use by the companies, development of this device is only a question of time.