

The Implication of
Substance over
Form and the Re-
Characterisation
of a Floating
Charge

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▣ THE IMPLICATION OF SUBSTANCE OVER FORM AND THE RE-CHARACTERISATION OF A FLOATING CHARGE

Introduction

The purpose of this Article is to consider the implications of the recent English case of *The Russell Cooke Trust Company Limited and Elliott*¹. Following this case, insolvency practitioners, preferential creditors, and third parties dealing with a company in the belief that its assets are subject to a floating charge (rather than a fixed charge) will need to examine the substance of the charge before dealing with those assets.

Summary

In the *Russell Cooke* case, the English High Court re-characterised a charge expressed to be a floating charge in a security document as a fixed charge on the basis of certain contractual restrictions imposed on the chargor in the security document. The Court adopted a “substance over form” approach in order to ascertain the true legal nature of the rights and obligations created. The Court held that the fact that the charge was labelled as a fixed charge was only one factor to be considered and was not the determinative factor.

This is the first English case to consider the re-characterisation of a floating charge into a fixed charge rather than the converse approach. The Irish courts have yet to consider a similar proposition but this type of contractual approach has been previously adopted by the Irish courts when considering the re-characterisation of a fixed charge into a floating charge².

Implications

The normal characteristics of a floating charge are that it floats over the assets in question until certain events occur (so-called “crystallisation events”) leaving the chargor free to deal with the assets (i.e. to sell it to third parties) which are subject to that charge in the normal course of business. Normally a third party who wishes to purchase assets which are subject

¹ *The Russell Cooke Trust Company Limited and Elliott* [2007] EWHC 1443 (Ch)

² *Re Wogan’s (Drogheda) Limited* [1993] 1 I.R. 157, *Re Keenan Brothers Ltd* [1986] I.R. 401, [1985] B.C.L.C. 302 (High Court), *Re A.H. Masser Ltd* [1986] I.R. 455

to a floating charge will seek confirmation of non-crystallisation of the charge from the chargor in order to ensure that they can obtain good title to the assets.

If the Irish Courts take the same view as the English Courts, then such a third party (or its legal advisers) would need to carefully review the contractual restrictions imposed in the security document in order to ascertain whether or not such a risk of re-characterisation arises. If the charge were to be re-characterised, the standard form of confirmation of non-crystallisation would not be sufficient and a formal release of security would be required before such assets could be acquired by the purchaser.

Any possible re-characterisation will not adversely affect those lenders who advance monies to a borrower on the foot of a floating charge. In fact, it will be beneficial to such lenders as the claims of such lenders as secured creditors pursuant to a floating charge will be subordinated to the claims of certain preferential creditors. However, if the charge is re-characterised as a fixed charge, the lender's claims as a secured creditor will take priority to the claims of these preferential creditors (other than the Irish Revenue Commissioners under Section 1001 of the Taxes Consolidation Act, 1997 in certain circumstances).

The Russell Cooke case

In the *Russell Cooke* case, the borrower, Causeway Investments UK Limited, had purported to grant certain charges (as secondary security) over various properties in favour of Elliot. Clause 3.1(b) of the relevant debenture document purported to create a charge: “by way of floating deed [over]: (1) all rights, title, estate and other interests of the Borrower in any one of the Properties not effectively mortgaged under [clause 3.1(a)]...” The reference to a floating deed is not a recognised term and the High Court acknowledged that this was an inapt expression. However it was regarded by the High Court to be clarified by virtue of clause 3.4 of the document which referred to this charge as a “floating charge”.

The main submission before the High Court for determination was that the restrictions in dealings with the properties imposed upon Causeway under the security document were inconsistent with the notion of a floating charge. In particular, clause 4 of the security document prevented Causeway from (a) creating or permitting to subsist any encumbrance or other right or option on any property; (2) selling, disposing of or assigning disposing of or dealing with any property; (3) exercising any powers of leasing or agreeing to lease or accepting the surrender of any lease; or (d) parting with or sharing possession or occupation of the property.

The High Court considered a number of cases, including *Re Coslett Contractors*³. Mr. Justice Mann referred to the findings of Millet LJ in that case and to his remarks that “The essence of a floating charge is that it is a charge, not on any particular assets, but on a fluctuating body of assets which remain under the management and control of the charger, and which the charger has the right to withdraw from the security despite the existence of the charge”. Mr Justice Mann also considered the case of *Re Agnew*⁴ and the leading English case of *Re Spectrum Plus*⁵ and applied the two step approach adopted in that case. Firstly, he considered the wording used in the debenture document and recognised that the wording claimed to have created a floating charge. Secondly, he considered the nature of the rights and obligations which the parties had created to see if they were consistent with a fixed or floating charge. He noted that the restrictions prevented Causeway from dealing with the assets without the consent of the chargee and he held that the restrictions were “simply inconsistent with the notion that the property in question was caught by merely a floating charge”. On this basis, Mr Justice Mann held that the charge in question took effect in law as a fixed charge.

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³ *Re Coslett Contractors Limited* [1998] Ch 495

⁴ *Agnew v. The Commissioner of Inland Revenue* [2001] AC 710

⁵ *National Westminster Bank PLC v Spectrum Plus Limited (in creditors' voluntary liquidation) & 5 ORS (Re: Spectrum)* [2005] 2AC 680

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