

Corporate Practice – Debt Cliffnotes

A. Company's Power

One needs to know whether a company can borrow debts for its specified purpose.

1. Companies Ordinance

- (a) [S.5A](#): a company has the capacity, rights, powers and privileges of a natural person.
- (b) [S.5B](#): a company shall not carry on any business that its memorandum states that it shall not do and shall not exercise any power that is expressly excluded by its MA or AA.
 - (i) So under [s.5B\(2\)](#), a member can bring proceedings to restrain a company from doing any infringing acts; however
 - (ii) a member cannot stop a company from fulfilling any legal obligations arising under contracts being performed; and
 - (iii) an act is not invalidated or void merely because of such a contravention.
 - According to common law, it would require actual notice of the breach of the MA or AA to invalidate the transaction (mere presence in the MA or AA is inadequate – [s.5C](#)) – [Rolled Steel Products 1986 CA](#).
 - If the act requires the passing of any resolutions under the MA or AA, the law will assume that such resolutions have been passed (internal management rule) – [Turquand 1856](#).
- (c) [Art.81, Table A](#): the company may borrow up to the nominal amount of the share capital of the company for the time being issued.
 - (i) However, the lender shall not be concerned to see or inquire whether this limit is observed. No debt incurred or security given in excess of such limit shall be invalid or ineffectual except in the case of express notice to the lender at the time when the debt was incurred ([Turquand](#) applied).
- (d) [Schedule 7](#) powers are all included unless expressly countered.

2. Exercises and Questions

- (a) *Read*: objects clause; articles; allotted share capital; any diversification of business; any notification to the bank of restrictive documents.

3. Execution of Debenture

- (a) Directors to pass necessary resolutions to approve execution of debenture and execution under seal (see [art.114](#)).
- (b) After execution, register debenture at Companies Registry.

B. Debentures

1. Definition

- (a) S.2, Companies Ordinance: ‘debenture’ includes stock, bonds and other securities whether or not a charge is effected.
- (b) Debentures are documents creating a debt or acknowledging it – Levy v Abercorris Slate and Slab Co. 1887.

C. Charges

1. ‘All moneys’

- (a) Bank overdraft facilities are done with ‘all moneys’ debentures. Such debentures secure ‘all moneys’ that may be owed by the company to the bank from time to time.
- (b) The term ‘*all moneys*’ **do not include previous monies lent by third parties**, the right to collect of which is later purchased by the bank – Re Quest Cae Ltd. 1985. Similarly, charges will not cover previous monies lent by third parties but later acquired.
- (c) If the previous monies were charged, then the bank can purchase that loan *together* with the relevant charge. This is better for the bank since ‘new money’ clauses would not otherwise be able to protect it.

2. Fixed Charges (as created)

- (a) A charge over ascertained and specified property that does not generally change in the normal course of business, e.g. equipment, machinery, premises, land.
- (b) Fixed charges over land may cover fixtures attached to the land.
- (c) “Fixed plant and machinery” are a term of art and mean that they must be attached to the premises in some way – Re Hi-Fi Equipment (Cabinets) Ltd. 1988. Such security must be established through evidence to be fixed to the land.
- (d) Have the highest priority in any event.

3. Floating Charges (as created)

- (a) Equitable charge on a class of unascertainable things present and future that usually change throughout the normal course of business, e.g. raw materials, finished goods, etc. and business continues as usual – Re Yorkshire Woolcombers Association 1903.
- (b) **Crystallisation occurs when a floating charge » fixed**
 - (i) Has *no effect on priority*.
 - (ii) Crystallising events implied in common law:
 - Appointment of a receiver;
 - Winding up commenced;
 - Company ceases to carry on business as a going concern – Re Woodroffes (Musical Instruments) Ltd. 1986.
 - If the debenture holder gives notice that the floating charge is to be converted into a fixed charge pursuant to the debenture.

(iii) **Automatic Crystallisation**

- Legal under the law – *Re Brightlife Ltd. 1986*.
- ‘Events of default’ may be freely negotiated in contract – *Re Permanent Houses (Holdings) Ltd. 1988*.
- Clauses often provide that charges crystallise immediately prior to events causing the crystallisation. Such clauses are effective in law – *Fire Nymph Products Ltd. v The Heating Centre 1992*.

(iv) A fixed charge created subsequent to a crystallised floating charge retains priority unless the new fixed charge holder has actual notice of the automatic-crystallisation clause and crystallisation condition that occurred.

(c) **Disadvantages of Floating Charges**

(i) Only where a company is being wound up, a floating charge as created (so it doesn’t matter if it crystallises) can be *invalidated* under *s.267* if it was:

- made ≤ 12 months before winding up commences (see mindmaps); or
- made when company was insolvent; or
- made to secure any previous lending – a floating charge would only be valid, despite insolvency to the extent of new monies charged at the time or after the creation of the floating charge. I.e. the charge will cover all monies issued after it despite insolvency.

That means that where a receiver gets stuff on behalf of the floating-charge holder *before* the company goes into liquidation or before it winds up, no preferred creditor can complain on *s.267* grounds (cf. unfair preference) – *Mace Builders (Glasgow) Ltd. v Lunn 1987*. This is useful to grab old monies that not secured by later ‘all moneys’ debentures.

(ii) Preferential creditors, e.g. IRD, gov’t and unpaid employees have priority over assets secured only by floating charges: *s.79(1)*, *s.265(3B)*.

(iii) Fixed charges created after crystallised floating charges still have **priority** unless the fixed-charge holder had actual notice of the clauses and facts effecting the automatic crystallisation process, e.g. negative pledge clauses and auto-crystallisation clauses – *Wilson v Kelland 1910*.

- Assets secured under floating charges can still be subjected to fixed charges because companies creating floating charges may generally, without the consent of the charge holder, deal with them in the ordinary course of business – *Wheatley v Silkstone 1885*.
- There is no constructive notice of the terms of a debenture in HK law even if it is registered because its particulars don’t have to be registered – *ABN Amro Bank NV v Chiyu Banking Corp. 2000*.
- The rationale is that crystallised floating charges result in equitable title, which is trumped by legal title (fixed charge) provided that charge holder has no actual notice.

(iv) Execution creditors have priority over a floating charge if the execution process had been completed by the time of crystallisation – *Re Standard Manufacturing Co. 1981 CA*.

4. Book Debt Charges

- (a) A book debt is a debt due to a trader which in the ordinary course of trade would be entered into his books.
- (b) Book debts may **only be subjected to a fixed charge** if proceeds of book debts go into blocked accounts, otherwise, they will only be subject to a **floating charge** and would be subject to preferential creditors.
- (c) Required terms – *NatWest Bank v Spectrum Plus 2005 HL*:
 - (i) Fixed charge over book debts;
 - (ii) Company to pay proceeds of book debts into designated account;
 - (iii) Company not to charge or assign uncollected book debts in favour of any third party;
 - (iv) Company not to withdraw or deal with book debts collected and deposited into the designated account.
 - (v) Bank to enforce ‘blocking’ of blocked account strictly.

5. Procedure

- (a) Charges, with Form M1 (particulars) must be registered within 5 weeks of creation: [s.80\(2\)](#).
- (b) Floating charges over land become registrable upon crystallisation: [s.56A CPO](#), [s.2A Land Registration Ordinance](#).
- (c) Particulars ([s.80\(1A\)](#)) and nothing else:
 - (i) date, description of instrument creating charge;
 - (ii) amount secured;
 - (iii) short particulars of property charged/mortgaged;
 - (iv) names, addresses, descriptions of persons entitled to the charge;
 - (v) details of any commissions or allowances payable to any person in consideration of his agreeing to subscribe to any debenture.
- (d) The time limit can be extended with such terms as the court thinks fit but shall not deprive any creditor of his claim to priority: [s.86](#).
- (e) **Effect of (Non)-Registration**
 - (i) So long as registered within the 5 weeks, the date of the instrument takes effect for priority purposes, otherwise, the date of registration is used.
 - (ii) For fraud, the certificate issued by the Company Registrar as conclusive evidence that the charge was registered ([s.83\(2\)](#)) can be set aside by the court.
 - (iii) If the charge is **not registered**, the holder of the charge is reduced to an unsecured basis: [s.80\(1\)](#). Officers knowingly in default are liable to be fined: [s.81](#).

(f) Administrative humdrum

- (i) Companies Registrar must keep a register for each company: [s.83](#).
- (ii) A company also has to keep a register: [s.89](#).
- (iii) Once a debt secured by a registered charge has been repaid, a memorandum of satisfaction should be entered on the register: [s.85\(1\)](#).

6. Priority**(a) Generally**

- (i) **Fixed charge holders**, excluding those with actual notice of negative pledge clauses of a previous floating charge.
- (ii) **Preferential creditors**
- (iii) **Holders of charges created as floating charges**
- (iv) Unsecured creditors

(b) Special Rules for floating charges involving auto-crystallise clauses (ACC)

- (i) *Prior floating charge with subsequent fixed legal charge*
 - Subsequent legal charge has priority since its legal interest trumps the equitable interest conferred by the floating charge.
 - The subsequent fixed charge holder does not automatically have notice of any crystallisation clause. Notice must be actual – [ABN Amro Bank NV v Chiyu Banking Corp. 2000](#).
 - *Book Debts* ✍
 - If charged assets are book debts (choses in action) then only an absolute assignment (deed of assignment) or blocked account arrangement can confer legal interest over them.
 - If assignment, then notice of assignment must be given to the third party debtor of the borrower: [LARCO s.9](#) compliance.
- (ii) *Prior floating charge with subsequent fixed equitable charge*
 - 2 equitable charges. First in time prevails.
 - Generally the prior floating charge would have priority.
 - *Book Debts* ✍ [Dearle v Hall 1828](#)
 - If charged assets are book debts (choses in action) then priority depends on who first gives notice of the charge to the debtor.
 - Holder of subsequent equitable fixed charge can *only* get priority if he notifies the debtor first, PROVIDED THAT he has no actual notice of the prior equitable floating charge.

(c) Land

- (i) Priority depends on date of execution of charge so long as charges registered within 30 days of creation at Land Registry. Else priority will depend on date of registration. Unregistered charge holders hold as unsecured creditors.

7. Remedies for the Creditor Against Defaulting Debtor

- sue under contract;
- petition winding up;
- appoint receiver pursuant to debenture;
- appoint receiver under common law (principal or interest in arrears – *Bissill v Bradford Tramways 1891*; company being wound up – *Wallace v Universal Auto Machines 1894*; security is in jeopardy, e.g. third party has obtained judgment and issued execution – *Re London Press Hinge 1905*).

(a) Receivership

- (i) Receives and sells assets for the creditor to satisfy debts, cf. liquidator.

(ii) Appointment

- Any time after demand by the Bank (per contract).
 - 1 hour held enough time for debtor to effect mechanics of payment – *Bank of Baroda v Panessar 1986*.
- Individuals only: [s.297](#)
- No undischarged bankrupts: [s.297A](#)
- No persons under disqualification order: [s.168D](#).

(iii) Effect of Appointment

- Notify CR within 7 days: [s.87](#)
- Give notice to debtor at registered/principal office.
- Register appointment at Land Registry if security includes land.
- Per contract, once a receiver has been appointed, the directors' powers of management are suspended.
- Floating charges become fixed, preventing the debtor from dealing with the collateral.

(iv) Agency

- Common law: agent of the debtor, so debtor is liable for acts of the receiver – *Re Vimbos 1900*.
- Per contract: usually agent of the creditor.
- Per statute (land): receiver appointed under [s.50\(2\) CPO](#) deemed agent of mortgagor.

(v) Powers & Duties

- Statutory powers for land: sell, insure/repair, employ agents and employees: [CPO Schedule 4](#).
- Otherwise per contract or per court order.
- Positive duty of floating charge receiver to pay preferential creditors under s.79 and s.265: [Inland Revenue v Goldblatt 1972](#).
 - Receiver is personally liable and the bank would hold the money on constructive trust.
- Duty to act in good faith, but no general duty of care owed to people with lesser priority – [Downsview Nominees v First City Corp. 1993](#).
- Duty to take reasonable care to get proper price, not best price – [Cuckmere Brick v Mutual Finance 1971](#).
- Statutory filing duties
 - file copy of Statement of Affairs at Companies Registry;
 - file Statement of Receipts and Payments [s.300A\(2\) CO](#).
- Termination of Receivership: notice to CR: [s.87\(2\)](#).

(b) Liquidation

- (i) Terminates receivers agency and removes powers of receiver to manage/run debtor's business.
 - Receiver can still sell charged assets validly charged.
- (ii) Liquidator has duty to unsecured creditors.
- (iii) Debtor stops trading and all property transactions become void.
- (iv) Can apply to invalidate floating charges and investigate unfair prejudice.

~ ~ ~