

EXAMINING THE LEGAL AND ECONOMIC INDICES OF PRIORITY OF FLOATING CHARGES: A COMPREHENSIVE ANALYSIS

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Abstract

Priority between security interests sets out the legal rules on priority of two security interests. The rules have never been susceptible to precise analysis. The rules are made more complex as the action of the parties often affects their legal positions. A debenture for instance could contain clauses authorising the crystallization of a floating charge into a fixed charge prior to the commencement of a winding up proceedings and could displace the priority of a fixed charge and/or preferential creditors of a company. This paper advances legal reasoning to contextualise the public policy and economic basis of floating charge. It concludes by putting forward the twin reasons why businesses prefer creating floating charge over assets in corporate financing; that is, flexibility and high interest rate.

Keywords: floating charge priority, economic, business benefit, security interest.

1.0 Introduction

Floating charge is a form of security having an asset or assets which may vary in number and economic value in the course of time. A business man in certain circumstances, in order to maintain his liquidity weighs the investment options before him by resorting to a dynamic asset as security. In Nigeria, a duly registered company can derive powers from its memorandum and articles of association get access to loan to manage its business affairs, projects and meet its obligations.¹ A floating charge can be said to be a security interest over a fund of changing assets, for instance, the stocks of a company or other assets, which ‘floats’ or ‘hovers’ until a certain point at which it is then converted into a fixed charge, at which point the charge attaches to particular assets owned by the company.

It has been argued that a charge is a mortgage of future assets since it is placed in abeyance until crystallization before it attaches to specific assets. In the case of *Evans v. Rival Granite Quarries Limited*,² Buckley L. J. held that “a floating security is not a future security, but a present security, which presently affects all the assets of the company expressed to be included in it. This was also emphasized in *Re Standard Manufacturing Co.*,³ that “It is a mortgage, presently affecting all the items expressed to be included in

¹ See Companies and Allied Matters Act (CAMA), Cap C20 Law of the Federation of Nigeria (LFN) 2020, s 191.

² [1910] 2KB 979.

³ [1891] 1 Ch at 627.

it, but not specifically affecting any item till the happening of the event, which causes the security to crystallize as regards all the items”.

Ferran,⁴ Gough,⁵ and Goode⁶ all agree that a floating charge is a present security and is not an agreement to create security in future. They see a floating charge as a charge security given by the chargor (debtor), conferring on the chargee (creditor) to exercise or hold an interest that is proprietary in nature over the charged properties, inventories or assets by way of security for the secured money or other secured obligations.

In the case of *Illingworth v Houldsworth*,⁷ it was held that a floating charge is ambulatory and shifting in nature, hovering over and so to speak floating with the property which it is intended 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. A description was subsequently given in *Re Yorkshire Woolcombers Association*⁸ where Romer L.J. succinctly defined a charge as a form of security over a class of assets that may be both present and future; and that class will be changing from time to time and until the charge crystallises and affixes itself to the assets, the party granting the charge may continue its regular business activities without constraint.

The concept of floating charges, are historically linked to private practice legal practitioners, wherein they coined the concept for business efficacy purposes. The creation of this legal device points the subject of law as a science. The very interesting but unconnected 1862 decision of *Holroyd v Marshall*,⁹ in a scientific manner it was held that equity would recognise a charge over later-acquired property as being effective to create an automatic security interest over that property upon its acquisition. The contributions of jurisprudential minds cannot be overemphasized.

This decision led to a further demonstration of the:

English genius for harnessing the most abstract conceptions to the service of commerce and industrial developments. Documents came to be drafted that purportedly granted security over all of the debtor's present and future property, but by contract expressly permitting the debtor to dispose of those assets, free from the charge, until such times as the debtor's business ceased. This charge came to be known as the "floating charge."¹⁰

⁴ E. Ferran, 'Floating Charge-The Nature of the Security' *Cambridge Law Journal*(1988) 47(2) 213.

⁵ W. J Gough, *Company Charges*, (2nd Edition, Butterworths, London, 1996) 72.

⁶ R. M. Goode, *Legal Problems of Credit and Security* (2nd Edition, London, Sweet & Maxwell, 1988)

⁷ [1904] AC 355 at 358.

⁸ [1903] 2 Ch 284.

⁹ [1862] 10 HL Cas 191.

¹⁰ James Chen, 'Floating Charge: Definition, How they are Used and Example' <www.investopedia.com> accessed on 15 March 2024.

It must be echoed, admitted and emphasized that this technical legal creation was quite innovative.

The first case in which a floating security device was tested and upheld came a mere eight years after *Holroyd v Marshall*¹¹; in *Re Panama, New Zealand, and Australian Royal Mail Co*¹² where the Court of Appeal held that:

The effect of the document was that despite allowing the company to continue utilizing its own assets until the company's winding-up process, the activation of this crystallization event granted the secured creditor the right to realize their security interest in the assets and assert priority over the general body of creditors. This apprehension was effectively dispelled by the House of Lords in the renowned case of *Salomon v A Salomon & Co Ltd*.¹³

The concept of the floating charge has also been scrutinized in industry-specific contexts, such as with product manufacturers and retailers. In such industries, the floating charge has proven to be a reliable form of security, offering an effective means of securing funding with inventories as collateral and thereby safeguarding ongoing business operations. This crystallization event typically occurs when the company defaults on loan repayment or enters liquidation. According to James;

Floating charge has also been considered in industry based argument such as products manufacturers and retailers, floating charge has been found to be a veritable security to provide an effective means to obtain funding with their inventories as collateral thereby preserving their business operations. In this way, crystalization occurs in a situation where the company neglects, fails or refuses to repay the loan or goes into liquidation.¹⁴

1.1 Features of a Floating Charge

The floating charge is a charge created over fund of assets of the company, to enable the company charge its changing assets as security and at the same time, continue to carry on its day to day business. This gives the borrower and lender confidence that while the company continues to carry on business, it will be in a good position to earn the money required to pay back its debts.

It is the essence of this charge that the right created under it remains dormant until the undertaking ceases to be a going concern, or until the person in whose favour the charge is created intervenes. His right to intervene may of course be suspended by agreement. But if there

¹¹ [1862] 10 HLC 191.

¹² [1870] 5 Ch App 318.

¹³ [1897] AC 22.

¹⁴ James Chen, (n 10).

is no agreement for suspension, he may exercise his right whenever he pleases after default.¹⁵

The essence and characteristics of floating charge have been summarized by Gough¹⁶ to be:

- i. that the chargor company is left to carry on business in the ordinary course of events.
- ii. the business itself is a going concern
- iii. that until some event occurs or some act is done on the part of the chargee, the chargor is left free to continue in business.

In the creation of a floating security, it should be noted that the manifestation of the intention to enter into legal relations with an additional ingredient that the enterprise or business of the debtor company is the subject matter of the security charge, but it would continue as a going concern.¹⁷ It has been noted by Stirling J,¹⁸ where he emphasised that so long as the company is a going concern, the charge has no legal right to interfere with the business of the directors of the company with respect to any specific portion or item of the company's assets.

1.2 Creation of a Floating Charge

There is no singular mode for creating a floating charge, however noteworthy is that the basic elements and requirements of a floating charge must exist in the arrangement. Where it can be shown that the contracting parties have intended that while the charge is in operation, the chargor can continue in business until there is an intervening event either flowing from the nature of the security as a floating charge or expressed by contract, then a floating charge has been created.¹⁹ No special words or formalities are needed, it will be enough if the instrument succinctly shows an intention for the property in question to be used as security.²⁰

In *National Provincial & Union Bank of England v Charnley*,²¹ the court remarked that it is clear that no specific form of words was necessary for the purpose of creating a floating charge where a company charged its assets in favour of a commercial bank. Similarly, Giffard L.J., in *Re Panama, New Zealand and Australian Royal Mail Co.*²² held that:

The effect of a floating charge is not based on the wording used to create same but on the nature of the charge.
Therefore, there must

¹⁵ W.J Gough, Op cit note 5.

¹⁶ W.J Gough, Op cit note 5.

¹⁷ *Re Florence Land and Public Works Co. Exp Moor* [1878] 10 Ch 530, at 540.

¹⁸ [1892] 1 Ch 434, at 435.

¹⁹ W.J Gough, Op cit note 4.

²⁰ *Craddock v. The Scottish Provident Institution* [1893] 69 L.T. 380.

²¹ [1924] 1 KB, at 431.

²² [1870] 5 Ch. App, at 318.

be the intention expressed contractually as between the parties to create a charge over the undertaking or fund of assets of the chargor company, for the time being while continuing in business and to be left free to deal with the assets so charged in ordinary course of business.

So long as the charge is constructed to cover over the whole or a specified part of the company's undertakings and assets, which may include cash and uncalled capital of the company,²³ and it may extend to both present and future.

2.0 Crystallization of Floating Charge

Crystallization is the process by which a floating charge security converts into a fixed charge security. As indicated by Kalu,²⁴

Crystallization of floating charges means transformation of floating charges into fixed charges upon the event of particular occasion. When the charge holder finds a way to implement his charge, a floating charge turns into a settled charge on the assets secured by that charge. Until a floating charge turns into a settled charge, the company is allowed to manage the property charged in any way it regards fit. In any case, once the floating charge solidifies, the company cannot arrange off the charged assets without paying off the charge holder.

This is guaranteed usually in a security document in two ways. In the first way, security contracts of floating charge usually carries with it an implied term that in the creation of a charge a cessation of the borrower's right to 'deal' with his charged-assets over which the charge is created in the ordinary/usual course of business entitles the lender to exercise a right to automatic crystallisation. On the other way, crystallisation usually occurs in a security contract over floating asset by stating expressly that a default on the part of the borrower will entitle the lender to exercise his right.

Additionally, crystallization also occurs where the borrower's business stops being a going concern or where both parties, the borrower and lender heads to court and the court exercise its power to appoint a receiver. This was suggested by the dictum of Lord Macnaghten in *Government Stocks and Securities Investments Co Ltd v Manila Rly Co.*,²⁵ That a charge should also crystallise upon the company ceasing to trade as a going concern.

²³ See Companies and Allied Matters Act (CAMA) 2020, s 203 (1).

²⁴ Kalu, Okaphor & Olekanma, 'Floating Charge: A Child of Equitable Circumstances and Its Hybrid Disposition' *NAUJILI*, 2012.

²⁵ [1897] A. C. 81, 87.

Crystallization occurs in two forms, automatic crystallization and express crystallization. The first type of crystallization is triggered by events such as a winding up, that is, the cessation of business or the appointment of a receiver by the court. It is conceded that, crystallization will occur automatically upon the happening of the above mentioned events and corporate lawyers would also couch security documents in a such a manner that will reserve such live triggers. The second type of crystallization include events or terms covering situations that can vary from case to case and are set out in the relevant security document of charge by way of contract. For crystallization to occur, someone on the part of the charge holder is usually required to do a thing, generally this will be the service of a "crystallization" notice upon the occurrence of specified events.

A floating charge generally remains dormant until it crystallizes or becomes a fixed charge, from the foregoing therefore, a floating charge crystallizes into a fixed security under the following conditions:

- (i) When company goes into liquidation,
- (ii) When company ceases to carry on business,
- (iii) When debenture holders or creditor take steps to enforce the security e.g, by appointing a receiver to take possession of charged property,
- (iv) On happening of an event specified in the deed.

Upon crystallization, the now fixed security assets(s) cannot be sold, and the lender may take physical possession of it. Essentially, once crystallized, the asset(s) underlying the security would no longer float in value; it must crystallize to protect or reduce risk for the bank or lender.

2.1.0 Priority of Floating Charge

The fundamental characteristics of floating charge remains a subject of controversy in academic: prior to crystallisation, the question of the nature of interest of a floating charge is yet to be settled. We will discover that third parties interests and that of the chargee heavily rely on this mute point.

As alluded above, it is a security interest for the chargee coupled with a business dealing license for the chargor. "Floating charge" is used as an omnibus term used to describe all forms of securities where assets are liable to be lost from the collection-of-security by 'permitted dealings'. It has been described as a child of equitable circumstances²⁶ or giving the chargee a mere equity that is, having a potential personal right to have fixed charge over assets in the event of crystallization. In *Re Woodroffes (Musical Instruments) Ltd*, The court held that:

- a. Mrs. W's charge, as a fixed charge, ranked ahead of the preferential creditors;
- b. the preferential creditors, ranked ahead of the bank's floating charge and;

²⁶ See n21.

- c. the bank's floating charge, by the express provisions of Mrs. W's charge, ranked ahead of the latter.

It follows that a floating charge would rank lower to subsequent security by virtue of the express agreement of parties and of course to preferential creditors, a percentage of unsecured claims, expenses of an administration and certain expenses of liquidation. The following discussion further expatiates priority of floating charge in perspective.

Generally, where the chargor grants a floating charge over all of its assets to the chargee, the Bank, and has also legally created a subsequent charge over the same receivables to other creditor, the competing interests of the chargee, the bank and the Other Third Parties with respect to such receivables may arise as to priority of settlement.

The general rule governing priority between charges over the same debts or receivables is the rule laid down in the English case of *Dearle v Hall*²⁷ that, priority is determined by the chargee or the bank, whose notice to the debtor is the first in time. However, with the condition that the bank chargee had no notice of any earlier charge in favour of any existing creditor and that he acted in good faith and for good value.

The above rule will not be applicable in a situation where receivables or such other assets covered by a floating charge are sold off or otherwise disposed of by way of a legal interest, in the absence of any restrictions in the security document against such disposal. In such circumstance, the analysis is that, since the chargor under the floating security document is allowed a business dealing right over its assets in the ordinary course of business until crystallisation occurs (which would include disposing of receivables), the legal purchaser or assignee of such assets or other receivables would take free of the prior floating charge. The implication is that the rule in *Dearle v Hall* would be inapplicable since by virtue of the creation of a floating chargee and in the absence of an express restriction, it will be taken to have legally permitted the chargor to effect the legal transfer of interest over assets and other receivables.

However, in the practice of corporate finance, corporate lawyers have always inserted restrictive devices or clauses to prohibit borrowers from placing encumbrances on an earlier charged assets having interests ranking higher in priority or ranking *pari passu* with, the charge in question. This is what referred to as a “**negative pledge device or clause**”. Moreover, floating charges may also include clauses stipulating that the charge will automatically crystallise upon the occurrence of certain events which may not require the intervention of the chargee. This is referred to as “**automatic crystallisation device or clause**”. The effect which such clauses may have on the Chargee or Bank's priority position is discussed as follows.

In the case of a *Negative pledge*, the intendment of this corporate financing device is that, if the lender's Floating Charge security document contains a negative pledge clause, such prohibition would generally not affect the other interests holders except where the other can be said to have had actual notice of the prohibitory clause at the time he entered into the agreement for legal assignment of assets. Where, at the material time, the other competing interest holder did have actual notice of such a prohibitory clause, the lender's interest in the assets would gain priority. In the realm of tort, the other interest holder could also be liable to the lender for procuring the borrower's breach of contract, and the courts could restrain it from enforcing its rights as a result of the prior agreement of which it had requisite knowledge.

On the other hand, an *Automatic crystallisation* device or clause operates in a floating charge security document to the effect that if the borrower acts contrary to a negative pledge clause stipulation by creating a subsequent interest without the consent of the prior floating chargee, the floating charge will automatically crystallise, and rank higher than any subsequent interest. Where the Lender's security instrument contains such an automatic crystallisation clause, it will trigger the Floating Charge to have crystallised before any other interest holder's legal assignment of assets or other receivables was effected. This is because the creation of subsequent charge ranking higher would trigger the floating charge mature or crystallise automatically.

The Court of Appeal in *Mubeco Pet. Co Ltd v B.O.I Ltd*²⁸ remarked that it is commercially unwise and unreasonable in the circumstances to allow or expect the bank to consent to a request for third party to compete with the bank *pari passu* by creating a second charge over the same assets or properties already mortgaged. It emphasized that withholding consent by the bank was not unreasonable if in the interest of the bank it will jeopardize its interest by allowing another bank share equally with it a collateral meant to secure repayment of a loan extended to the customer.

In the instance where the creditor or other interest holder's legal charge is effected after crystallisation of the lender's floating charge, it means that the lender's interest in the assets in question or other receivables would rank higher in priority being first in time, by virtue of the occurrence of crystallisation, it displaces the existence of an implied term authorising the borrower to dispose of the assets or other receivables to the other interest holder. Recall that notice is required to effect a legal assignment under the rule in *Dearle v Hall*, therefore, the rule applies.

It follows that, priority between competing interests over charged assets or receivables is determined in accordance to the line of order in which notice is given to the customers. Where notice was first served by other interest holders in order to perfect their legal assignment before the lender and has no notice of crystallisation of the lender's charge, first in time prevails by the rule in *Dearle v Hall*.

²⁸ [2021] 13 NWLR 159.

2.1.1 Does registration of a charge confer notice of a negative pledge clause or automatic crystallisation clause?

It is a statutory requirement for charges created over company's assets to be registered with the Corporate Registry. Registration of a charge in Nigeria is now simplified through the company Registration Portal online. Generally, registration of charges constitutes constructive notice of the existence of that charge to every other subsequent chargee and assignee. The legal implication of constructive notice is that in the absence of actual notice that is, personal knowledge, a subsequent chargee or assignee will be held to have notice of an earlier registered interest.

By law, the general public have access to conduct company search through the Company Registration Portal. This gives company lawyers knowledge of the existence of automatic crystallisation clause and negative pledge clauses enshrined into a floating charge instrument and already lodged at the Corporate Registry. The Companies and Allied Matters Act requires that charges be registered not later than 90 days beginning with the date after the date of creation.²⁹ The transparency affords business efficacy in the world of corporate financing.

2.1.2 Priorities where the Third Party's Rights are Created after Crystallisation

The essence of crystallisation is to terminate the borrower's licence to deal with assets covered by charge instrument. The prior authority of the chargor to deal with the company assets in the usual course of business is extinguished. The interest of the chargee now attaches and translates to fixed charge. The chargee's right becomes indefeasible. However, where the borrower creates a subsequent third party security interest over the same set of company assets, a question for determination of priority over the competing interests will arise. The lender's crystallised security interest will prevail by the rule of priority, being first in time. Third party is a *bona fide* purchaser of a legal estate under the crystallised floating charge or unless estoppel operates the normal order of priorities between equitable interests.³⁰ An encumbrance would cover any transaction with legal or economic effect of depriving the creditor of its security interest.³¹

The principle of *estoppel* will be applied by the court where the lender's interest is a floating charge. The courts have in several cases upheld the lender's prior interest over third party interest where the parties acted in bad faith that is, third party had notice of the existence of the prior charge and the borrower was in breach of the agreement not to

²⁹ See CAMA 2020, s 222.

³⁰ See the following cases *Re Crompton & Co. Ltd.* [1914] 1 Ch. XC 954; *Re Woodroffes (Musical Instruments) Ltd. (in liq.)* [1986] Ch. 366; *Hubbuck v. Helms* [1887] 56 L.J. Ch. 536; *Stein v. Saywell* [1969] 121 C.L.R. 529; *Re Manurewa Transport Ltd.* [1971] N.Z.L.R. 909; *Re Permanent Houses (Holdings) Ltd.* [1989] 5 B.C.C. 151. It can also happen semi-automatically if the agreement provides, that is, when the chargee gives notice to convert the floating charge to a fixed charge: *Re Woodroffes (Musical Instruments) Ltd. (in liq.)* [1986] Ch. 366; *Biggerstaff v. Rowatt's Wharf Ltd.* [1896] 2 Ch. 93; *George Barker (Transport) Ltd. v. Eynon* [1974] 1 W.L.R. 462; *Stein v. Saywell* [1969] 121 C.L.R. 529; *Re London Pressed Hinge Co. Ltd.* [1905] 1 Ch. 576.90.

³¹ *Malayan Banking v ASL Shipyard Pte Ltd* [2019] SGHC 61 at 90.

deal.³² In *Torzillu Pty. Ltd. v. Brynac Pty. Ltd.*,³³ the third party had knowledge of the existence of the floating charge, in fact, the third party knew of the details of the content and acted *mala fide*. The court held that the interest of the lender will prevail. Also, the courts have had cause to uphold priority in favour of a lender even where no reference was made to notice or knowledge.³⁴ It must be noted that ordinarily, the interests of an innocent purchaser for value without notice of an existing prior security interest and without notice of the existence of a bar on licence to deal with assets will take free and prevail.³⁵

2.1.3 Priority where the Third Party's Interest is Created prior to Crystallisation and within the Licence Provisions

Where within the permitted acts a deal is struck to create subsequent security interest in favour of third party prior to crystallisation, without much ado, the question ought to be resolved very simply in favour of the third party. On the condition that the interest created was done within the allowable confines of the license to deal, then the chargee's interest must be placed in abeyance. The third party must take free of the floating charge.

We may have a situation whereby at the time of crystallisation, the third party transaction had not been completed. Inchoate transactions are bound to happen in an agreement for sale or in debt transaction or other transactions that brings about a contractual lien. In such circumstances, the above principle may not strictly apply due to the interruptions. In such situations, the principles of passage of property in the goods will apply. In all circumstances where crystallisation interferes with a license to deal. Where it is shown that the property right in the goods in question has passed to the third party, at the occurrence of crystallisation, the chargee's rights will be considered extinguished. The court will firstly be interested in the inquiry of whether the interest transferred emanated from a license to deal. Once the court is satisfied, then second question of whether or not the interest of the third party is a mere equity or proprietary in nature becomes an issue.

2.1.4 Where Third Party's Interest is Created Contrary to Terms of the Licence and Prior to Crystallisation

It is not unusual to have cases where the borrower in spite of the existence of subsisting charge contrary to the agreed terms of the business dealing licence, creates subsequent security interests over property or assets covered by a charge.

³² *Cox v. Dublin City Distillery Co.* [1906] 1 I.R. 446; *Re Manurewa Transport Ltd.* 11971J N.Z.L.R. 909; *Deputy Commissioner of Taxation v. Horsburgh* [1984] V.R. 773.

³³ [1983] 8 A.C.L.R. 52

³⁴ In *Re Benjamin Copc & Sons Ltd.* [1914] 1 Ch. 800 and *Re Household Products Co. Ltd. et al. and Federal Business Development Bank* [1981] 124 D.L.R. (3d) 325 there is no reference to knowledge or notice; both found in favour of the chargee.

³⁵ *English & Scottish Mercantile Investment Co. Ltd. v. Brunton* [1892] 2 O.B. 700.

The example of the Nigerian case of *Mubeco Pet. Co Ltd v B.O.I ltd*³⁶ where the agreement expressly restricted the Appellants not to create subsequent security interest without the prior consent of the lender-bank. the court agreed with the argument of the Respondents to uphold the terms of contract and that withholding consent was not unreasonable.

As a general rule, the interests of the chargee are not extinguished by acts of the chargor outside the purview of the business dealing licence. In other words, the interests of the chargee subsists over the assets. However, the question of priority of the prior interest and subsequent interest is determined below.

There are several possibilities we may have with a subsequent creation of charge. Take for instance a third party interest certain specific assets, subject to all existing equities. We may even have a situation with an open ended clause binding parties whether or not the existence of any equity is brought to the notice of the third party. In such agreements giving a wide contractual flexibility, the interests of the lender will prevail over and above that of third party.

There is also the possibility of the operation of equity's darling, that is, where a subsequent holder of the legal interest over charged assets for value without notice of the prior existing equitable interest will take free of the lender's interest.³⁷ However, if the *bona fide* purchaser had notice of the lender's existing interest, then the lender's interest will prevail.³⁸ It is submitted that with the requirement for the registration of charge, notice ought to be inferred in every subsequent transactions.

3.1.0 The Economic Benefits of Floating Charge

There are a number of incentives for lenders to accept a floating charge as a security, particularly when dealing with small companies. Although a fixed charge seems to be a superior security in general,³⁹ the floating charge becomes an important security where a business does not have significant fixed assets.

Floating charge may well be the only type of a security that small companies are able to provide. Therefore, in such circumstances the floating charge seems to be close to an ideal security. The holder of a floating charge in this regard is better protected than an unsecured creditor.

³⁶ [2021] 13 NWLR 159.

³⁷ *English & Scottish Mercantile Investment Co. Ltd. v. Brunton* [1892] 2 Q.B. 700.

³⁸ *Cox v. Dublin City Distillery Co.* [1906] 1 I.R. 446; *Torzillu Pty. Ltd. v. Brvnac Pty. Ltd.* 8 A.C.L.R. 52; *Hamilton v. Hunter* [1982] 7 A.C.L.R. 295; *Re Bartlett Estates Pty. Ltd.* [1988] 14 A.C.L.R. 512.

³⁹ See Companies and Allied Matters Act (CAMA) 2020, s 204 which provides that a fixed charge on any property shall have priority over a floating charge affecting that property, unless the terms on which the floating charge was granted prohibits the company from granting any later charge having priority over the floating charge.

Moreover, the floating charge holders may protect themselves against other lenders using negative pledges. These are clauses in the debenture restricting or prohibiting the creation of subsequent charges. In case a subsequent charge holder is deemed to have notice of the negative pledge, then the floating charge holder has priority over them in insolvency situations.

Furthermore, the mere fact that the floating charge holder is able to enforce the charge gives him or her some control over the company. Particularly for small companies, the effects of the floating charge holder enforcing their rights would be disastrous, a likely consequence is the cessation of business if the charge is turned into a fixed charge for instance, over the company's book debts, which deprives the company of its cash flow. Therefore, small companies have an incentive to keep the floating charge holders satisfied.

Consequently, many companies provide financial statements to their debenture holders. Therefore, the floating charge holders are informed if the company is facing parlous times. This is advantageous as it will facilitate the floating charge holders' understanding of the risk of the debt.

From a corporate finance perspective, the increased risk arising from an imperfect security such as floating charge will justify the charging of a higher interest rate from the company. The lender will compensate for the additional risk arising from a floating charge by charging a higher rate of interest. Lenders who seek higher returns will have to accept a higher level of risk. Thus, the floating charge becomes an interesting security for them. To an investor, this is a trading strategy, a derivative gain and a form of hedging technique.

Moreover, the flexibility of a floating charge is advantageous to both companies and lenders. The company will be free to deal with the assets under the floating charge. This benefit is a particularly valuable means whereby a business concern can raise money without removing any of its property from the business. The charge holders will benefit from the fact that the charge attaches to all assets in a class. Though, the risk remains that the value of assets may decrease over time.

Finally, perhaps the greatest advantage of the floating charge has been the power to appoint an administrative receiver and to block the appointment of an administrator if the company becomes insolvent. Thus, the floating charge holders have an advantage as liquidations will ensure maximum return to them.

In all, it seems that there are several reasons why banks and other lenders should accept a floating charge as a security.

3.1.1 The Drawbacks of Floating Charge

There is much about the floating charges that makes them unsatisfactory securities for lenders. Its vulnerability of a company risk of assets dissipation. Statutory drawbacks such as preferential creditors, defective creation of floating charge and cost of liquidation which requires an out of company assets expenses.⁴⁰ Assets under floating charge constitutes company assets and properties.⁴¹ Such expenditures necessarily affects and reduces the interests of the lender.

The floating charge is an uncertain instrument as it creates an interest over a fluctuating amount of assets. Therefore, the charge holder is left in doubt as to how much of debt one can recover by realising the security. A floating charge is a less secure type of lending because the lender has no way of knowing whether the assets left in the stockroom when the charge 'crystallises' will cover the debt owed. The company may dissipate the assets subject to the charge, arguably the most serious risk that the charge holder faces.

Another risk arises from the low priority given to a floating charge holder when distributing the proceeds of insolvent liquidation. The fixed charge holders have the highest claim and also the preferential creditors such as employees of the company⁴² rank higher in priority than the floating charge holders. The prospects for the floating charge holder to receive any material recovery out of the realisations from floating charge assets are subject to uncertainty.

4.0 CONCLUSION

Flowing from the foregoing, floating charge can be a weakness, from the economic point of view. A floating charge takes effect in equity, a child of equitable circumstances and therefore, it is subject to the vulnerabilities of an equitable interest. It does not bind a *bona fide* purchaser for value without notice. Moreover, it has been debated whether floating charge holders have a proprietary interest at all before crystallisation. The consensus view that floating charge confers an equitable interest in favour of the chargee from the time of its creation coupled with a licence in favour of the company to deal with assets in the ordinary course of business. The point therefore, has been made that floating charge is unattractive debt finance due to the business dealing license for the chargor. However, higher returns from high interest rates and the seeming flexibility in the creation of floating charge counts as strength in terms of corporate financing options.

⁴⁰ Emuobo Emudainohwo, A Critical Analysis of the Nature and Effectiveness of a Floating Charge as a Security in Nigerian Law' Beijing Law Review march 2021 vol 12 no 1

⁴¹ Re Barley Corn Enterprises Ltd [1970]

⁴² See CAMA 2020, s 657.