SYMPOSIUM ON REMEDIES ON DEFAULT

Comment by

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I would like to turn first to the statement in the case study which indicates that the fixed and floating charges contain provisions for "self receivership" and "directions".

In the course of the last five years or so, the concept of self receivership has appeared in a number of project financings. This has been introduced, in my experience, at the request of the borrower, as a way of finding a half-way house between the performance of the agreement and the appointment of a receiver. Generally speaking, these provisions have given the borrower the opportunity in certain circumstances to comply with specific directions of the lenders as regards the disposal, say, of particular items of property before the lenders can elect to appoint a receiver.

There is no reason for limiting this concept to project financings. It seems to me, that there may be good reasons why the banks themselves could have considered introducing such provisions in the charge.

The appointment of a receiver will have very severe consequences for a borrower. Not only will it trigger cross default clauses, it will bring upon a borrower the stigma of receivership with likely effects on its ability to trade, and it may well affect and in fact destroy, particular assets of the company, such as statutory licences.

The opportunity these provisions would give for the directors to comply, or to be obliged as a matter of comfort to comply with specific information may avoid all of these consequences without it appears being prejudicial to the lender.

Of course, if the directors failed to comply with the bank's directions, that in itself would be an event of default and a receiver would be appointed. It seems the only problem with this idea is confirmed in the definition of director in section 5 of the Companies Code. That says that a "director" includes any person in accordance with whose directions or instructions, the directors of the corporation are accustomed to act.

The question to consider is whether compliance with specific requests of banks to do a small number of things, say to sell a major asset, would involve the bank in becoming a director of the corporation. I doubt that it would.

The reason I suppose that this concept of "self receivership" is not customarily called for by banks is that they have a large stick to wave where a company which was given general security is in default of its obligations can go to the directors and say, "look here, either you sell off these asset or you do this or do that, or we'll appoint a receiver". Very often the directors will comply.

It seems to me however it would be worth thinking of documenting such a provision from the outset, as a way of finding a useful half-way house.

The second topic that I am asked to consider, is the crystallization of the floating charge. The problem states that the charges are to be fixed and floating, so I have assumed that we have considered as to which assets they should be fixed and as to which they should be floating.

The temptation is to think of taking a fixed charge over everything in light of the company's financial position. One would be mindful of the statutory provisions such as sections 452 and 331 and 446 of the Code. My view is that that temptation should be resisted so far as possible, and of course it may well be quite impossible to have fixed charges over all of the company's assets, depending on the nature of the business. Generally speaking I think we can limit the fixed charges to particular assets of the company and as to the balance be satisfied with floating charges, but incorporate provisions providing for automatic crystallization.

Now, probably most of you are aware of the concept of automatic crystallization which has been around now for about 15 years and blessed in cases such as Stein v Saywell (1969) ALR 481 and Manurewa Transport (1971) NZLR 909 and in Bill Gough's "Company Charges" page 96 and Supplement page 3, Roy Goode's "Legal Problems of Credit and Security" page 40. The normal procedure is to pick a number of events, the occurrence of which would automatically crystallize the floating charge and also to provide that the banks may, by giving notice at any time, crystallize the floating charge.

If you take a look at paragraph 5 of the problem, you will see towards the end it says that the banks became aware that the directors of Holdco were disposing of assets before the banks were in a position to crystallize the floating charge and secure the appointment of a receiver and manager. Normally of course a charge is crystallized when a receiver and manager is appointed. A charge is also crystallized if the company ceased carrying on business or if a mortgagee went into possession.

This is just the case where a provision that the banks could by notice crystallize the charge at any time. This brought with it the normal disadvantages of having a fixed charge, it also means that where appropriate we can take advantage of the rule in Dearle Hall. It means that we can stop execution creditors, and that we can present rights of set-off accruing by defeating mutuality.

Unfortunately of course it doesn't give us a leg up with section 452, if you are hoping it might, because as far as that section is concerned, once a floating charge - always a floating charge.

Assuming that the charge was drawn differently from the way I have just suggested, the banks have the option of going to the court and seeking the appointment by the court of a receiver on the basis that their security is in jeopardy. The cases dealing with that don't seem to me to be conclusive on the facts in the case study and indeed I am inclined to think that they wouldn't succeed.

A receiver has been appointed by the court in cases where, for example, the company is insolvent and its business has stopped, even though winding up proceedings haven't commenced. A court has appointed a receiver where execution has been levied by a creditor and other claims are pending and even where a creditor has obtained a judgment and is in a position to issue execution. But there is authority for the proposition that a mere holder of the floating charge does not have standing to obtain an injunction against the company dealing with its assets, unless the security is in jeopardy. I suppose that is hardly surprising because after all that is what a floating charge is all about.

One may be able however to draw some comfort from Re Borax Co (1901) 1 Ch 326 where the court considered an imminent breach of a clause restricting further encumbrances.

Let's say that our floating charge said that it would crystallize if steps were taken to sell an asset of the type which the directors are proposing to sell. Assume that the company has a Steel Mill and the charge says that if the directors attempt to sell the Steel Mill that will be an act which will automatically crystallize the floating charge. It would seem to me probably to be the case that one could then go to the court and say that that act is in the category on the basis of Re Borax Co where the attempted disposal of the asset ought to be a ground on the basis of jeopardy to the security of appointing a receiver. At least that is what I am arguing and I would be interested to hear who thinks I would be successful.