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Hanging in the Balance: Securing a Company's Debt by a Fixed or Floating Charge?

1. Introduction

Financial inter-dependence is commonplace for humans and companies alike. Recourse is usually made to surplus units (humans and companies) when a company seeks to finance its objectives. This general requirement for financing is dependent on repayment (principal sum plus interest or dividend). When repayment of financing provided for a company's objectives is restricted to the company's earnings, it is termed corporate finance. On the other hand, project finance (the financing of a company's specific project), is repayable from the project's cashflow. Project finance and corporate finance are obtainable through equity, debt or a hybrid of both.

When they are obtained through debt (especially loans), the creditors are inclined to mitigate the inherent risks of a debt transaction (e.g. default in repayment) by questing for, evaluating and opting for assets of the borrowing company as security. Whilst the quest is confined to the borrowing company's available assets, evaluating assets is multifaceted. An evaluating creditor will not only assess the available assets, but also the way (mortgages, pledges and charges) best suited to create security over them. This article focuses on one of such ways, a charge, revealing its classifications, and the advantages and disadvantages of its classification to creditors.

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2. Nature of a Charge and Chargeable Assets

A charge is created when a borrowing company (the chargor) uses its asset(s) to secure a debt which it owes to a creditor (the chargee). The asset(s) secures the debt in the sense that the chargee is empowered to realise the debt from the charged asset(s) (through the aid of a receiver) when the chargor fails to repay the debt or becomes insolvent.[2]

In corporate finance, the charged asset(s) can be a single asset, a class of assets (assets with similarities), a group of assets, or all of the assets on the chargor's balance sheet.[3] On the other hand, in project finance, the charged asset(s) can be the project sought to be financed (non-recourse), or an intermix of the project and some other assets on the chargor's balance sheet (limited recourse). The assets on the chargor's balance sheet usually consist of real property, and personal property (tangible or intangible). In law, tangible personal properties are palpable properties capable of physical possession (e.g., the chargor's vehicles and equipment).[4] On the other hand, intangible personal properties are legally referred to as things-in-action because legal action is required to possess them (e.g. the chargor's shares and bank account).[5]

Opting to charge any of the aforementioned types of assets largely depends on the chargee's discretion which is influenced by things like its personal interests, end goal and safety. For instance, a cautious chargee may insist on a charge on real property, because it is less unlikely to be an object of fraud. In another light, a chargee who may have an underlying interest in attaining ownership in a chargor may tilt towards a charge on the chargor's share capital. This is because, upon failure to repay the debt which the charged shares secure, the chargee can apply to a court to convert the debt owed to an equity share in the chargor.

When the chargee finally selects the asset(s) to be used as security in agreement with the chargor, its particulars, mode of realisation, rank in priority, and other terms

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[2] See generally, Ayodele Ashiata Kadiri, 'A Review of the Nigerian Law and Practice on Perfection of Charges' *The Gravitas Review of Business & Property Law* Vol.12 No.3 September 2021.

[3] See generally, Clement fondu, 'Taking Security in Nigeria: A Comparative Guide for Investors', *Latham and Wakins*, available at https://www.lw.com/admin/Upload/Documents/Taking%20Security%20In%20 Afri ca/Taking-Secur ity-In-Africa-Nigeria.2.pdf, accessed 25th January 2025.

[4] *Ibid.*

[5] See generally, Emmanuel Bassey 'Assignment of Choses in Action', available at https://spaajibade.com/assignment-of-choses-in-action/ accessed 25th January 2025

are usually documented in a Security Agreement. A Security Agreement may be in the form of:

i. A Security Deed; used when one, a group, or a pool of the chargor's assets is used to secure a debt (e.g., a Deed of Share Charge, a Deed of Account Charge).

ii. A Deed of All Asset Debenture; used when all the chargor's assets are used to secure a debt.

3. Differentiating a Charge from a Mortgage and a Pledge.

A mortgage, pledge and charge are all similar in that they transfer interest in a borrowing company's asset(s) to a creditor as security for the debt owed by the borrowing company to the creditor. However, the difference between these security transactions lies in the type of security interest that they transfer to the creditor. When a debt is secured by way of a charge, the borrowing company (the chargor) gives the creditor (the chargee) a proprietary interest over the charged asset(s).[6] This propriety interest simply entails a registrable and transferable right to realise the debt from the charged asset(s).[7]

On the other hand, when a debt is secured by way of a mortgage, the borrowing company (the mortgagor) transfers to the creditor (the mortgagee) legal title over the mortgaged asset(s), which ceases upon redemption of the mortgage by repayment of the debt.[8] Similarly, when a debt is secured by way of a pledge, the borrowing company (the pledgor) gives the creditor (the pledgee) possessory interest in the pledged asset, which ceases upon redemption of the pledge.[9] The effect of the different interests transferred by these aforementioned ways of securing a debt vary. For a mortgage, the legal title transferred to a mortgagee, makes the mortgagee entitled to the mortgaged asset(s) over all persons (including the mortgagor) until redemption of the mortgage.[10] This overriding interest means that, If the mortgagor defaults in repaying the debt which the mortgage secures, the mortgagee can unilaterally divest the mortgaged asset(s) in other to recover the debt.[11] Contrariwise, a charge, which only gives the chargee a registrable and transferable right to realise

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6 Ayodele Ashiata Kadiri, 'A Review of the Nigerian Law and Practice on Perfection of Charges' *op cit.*

7 *Ibid.*

8 *Ibid.*

9 *Ibid.*

10 Adetona v. Zenith Bank Plc (SC) (2011) 18 NWLR (Pt. 1279) 627 at pp. 644-645, paras. A-G.

11 This is conditional upon the happening of the events prescribed by the law and the deed of mortgage for the mortgagee's power of sale to arise and become exercisable. See, Ihekwoaba v. A.C.B. Ltd (SC) (1998) 10 NWLR (Pt. 571) 590 at p. 609, paras. D-G; at p. 612.

the debt from the charged asset(s), does not empower the chargee to exercise such power of sale.[12] A chargee can only exert slight dominance over the charged asset(s) by precluding the chargor from dealing with the asset(s) without its consent. If this aforesaid restriction exists, the charge is said to be a fixed charge. Aside from a fixed charge, the second way of creating a charge over assets of a borrowing company is a floating charge.

4. Ways of Creating a Charge: A Fixed or Floating Charge

As earlier identified, there are two ways of creating a charge over assets of a borrowing company: a fixed charge and a floating charge. These two ways are employable in both corporate finance and project finance.[13] Whichever it is employed in, a fixed charge is one which, from its inception, precludes the chargor from dealing with the charged asset(s) without the chargee's consent. This nature of a fixed charge starkly contrasts a floating charge, as the latter's name suggests.

The designation, floating charge, is predicated on the fact that the charge floats/hovers over the charged asset(s) and only becomes fixed when a crystallising event occurs.[14] What amounts to a crystallising event is dictated by the express terms (the terms of the security agreement) and the implied terms (applicable laws). In Nigeria, section 203 of the CAMA, 2020[15] provides that a floating charge that was used to secure a debenture (a type of debt corporate finance) crystallises when the company goes into liquidation, or the chargee appoints a receiver to enforce the debt owed to it, or a court appoints a receiver on the application of the chargee.

The fact that a floating charge needs to crystallise and a fixed charge does not, means that a fixed charge ranks higher in priority than a floating charge. To that end, if a company's debt is secured by a floating charge on all its factories, and another secured by a fixed charge on a factory, are enforced at the same time, the debt secured by a fixed charge will be realised from the factory first before the debt of the floating charge is realised.[16] If it is the debt secured by a floating charge that becomes enforceable first, any appointed receiver is mandated by law to realise the debt secured by a fixed charge from the factory before realising the debt secured by

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12 Ihekwoaba v. A.C.B. Ltd (SC) (1998), *op cit.*

13 Okechukwu J Okoro and Oluwatoyin Nathaniel 'Creating collateral security packages for project finance transactions in Nigeria' *Lexology*, Avaliable at https://www.lexology.com/library/detail.aspx?g=f544a4f6-a8f6-43ad-8836-a4ce5472a49f,accessed 25th January 2025.

14 Ilingworth v Houldsworth (1904) AC 355.

15 Companies and Allied Matters Act, 2020.

16 Kadzi Intl Ltd. v. Kano Tannery Co. Ltd (SC) (2004) 4 NWLR (Pt. 864) 545 at p. 577 paras A-D.

a floating charge.[17] Similarly, when the chargor is in liquidation, its debts secured by a fixed charge will be settled before its debts secured by a floating charge.[18] However, a floating charge can rank higher in priority if the security agreement between the chargor and the chargee provides as such, and the chargee of a future fixed charge is given prior notice of this priority claim.[19]

5. The Distinctive Features between a Fixed Charge and a Floating Charge

Historically, there have been three distinctive features which separate a fixed charge from a floating charge. They are as follows:

i. A fixed charge is a charge on specific identifiable asset(s), while a floating charge is a charge on a group or pool of assets, both as constituted in the present and in future;

ii. the assets subject to a floating charge change periodically in the ordinary cause of business, while the asset(s) subject to a fixed charge does not; and

iii. a fixed charge, from its inception, precludes the chargor from dealing with the charged asset(s) without the consent of the chargee, while a floating charge permits the chargor to deal with the charged assets until the floating charge crystallises.[20]

More recently, there has however, been a fundamental shift from two of these distinctive features. This was due to trends where security agreements place a charge on a group or pool of assets, past or present, but still precludes the chargor from dealing with the assets.[21] It therefore became widely accepted that the only true difference between a fixed charge and a floating charge is that the former precludes the chargor from dealing with the charged asset(s) without the consent of the chargee.[22]

The writer aligns with the view that, while the asset(s) of a fixed charge and floating charge have their usual nature,[23] the reverse could be the case. Nothing stops a

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17 Kadzi Intl Ltd. v. Kano Tannery Co. Ltd (SC) (2004), *op cit.*

18 *Ibid.*

19 Section 204 Companies and Allied Matter Act, 2020. This does not apply to project finance.

20 Deduced from the old English case of Re Yorkshire Woolcombers Association Ltd (1903) 2 Ch 284.

21 Sarah Worthington, "Floating Charges An Alternative Theory", The Cambridge Law Journal 53, No. 1 (1994): 81–103, available at http://www.jstor.org/stable/4507904, accessed 23rd January2025.

22 Per Lord Scott, National Westminster Bank plc v Spectrum Plus Ltd (2005) UKHL 41; Per Justice Johnson J, Re Avanti Communications Limited (2023) EWHC 940.

23 The assets used to secure fixed charges are usually specific and identifiable. Inversely, floating charges are usually secured by groups or pools of assets (as constituted in the present and in future).

chargor and a chargee from agreeing to create a charge that precludes the chargor from dealing with an ever-changing group or pool of assets without the consent of the chargee. Another reason to align with this view lies in two tenets of a floating charge. Firstly, it is commonly accepted that, the assets subject to a floating charge are usually ever-changing. it is also commonly accepted that a floating charge converts into a fixed charge upon crystallisation. This conversion, which henceforth precludes the chargor of a floating charge from dealing with the charged asset(s) without the consent of the chargee, does not change the usual dynamic nature of the asset(s) subject to a floating charge.

It is therefore reasonable to deduce from this that, the only true distinctive feature, is the prohibition from dealing with the charged asset(s) placed on a fixed charge, and not the ever-changing nature of the asset(s) of a floating charge. This prohibition placed on a fixed charge means two things: the chargor can neither utilise the charged asset(s) in the ordinary course of running its business nor use the charged asset(s) to secure future debts without the consent of the chargee.[24]

On the other hand, the extent to which a chargor of a floating charge is permitted to deal with the charged asset(s) depends on the terms of the security agreement between the chargor and chargee. Notwithstanding this, the permitted dealings will usually not include dealings that can bring an end to the life of the security, or the chargee's interest in the security. For the chargor, these two aforesaid implications of the prohibition from dealing with the asset(s) of a fixed charge without the consent of the chargee, are the disadvantages of opting for a fixed charge over a floating charge, and vice versa. For the chargee, there are numerous advantages and disadvantages that must readily come to mind, which are discussed below.

6. Advantages and Disadvantages of a Fixed Charge

6.1 Advantages

6.1.1 In corporate finance and limited recourse project finance, realising the traditionally small assets of a fixed charge is faster and easier for a receiver than that of a floating charge.

6.1.2 In corporate finance and project finance, there is no possibility of the charged asset(s) depreciating due to managerial inadvertence by the chargor.

[24] Sarah Worthington, "Floating Charges An Alternative Theory" *op cit*.

6.1.3 In corporate finance and project finance, a fixed charge takes priority over a floating charge.

6.2 **Disadvantages**

6.2.1 In corporate finance and limited recourse project finance, there is a relatively higher risk of depreciation of the traditionally small assets of a fixed charge.

7. Advantages and Disadvantages of a Floating Charge

7.1 **Advantages**

7.1.1 In corporate finance and limited recourse project finance, there is a relatively lower risk of depreciation of the traditionally large assets of a fixed charge.

7.1.2 A chargee whose floating charge was used to secure a chargor's debenture, (a long-term debt corporate finance)[25] takes up unique rights in that chargor as a corporate entity. These rights include:[26]

i. The right to dissent to change in objects of the chargor, which succeeds if an aggregate of 15% of the holders of the chargor's debentures that are secured by a floating charge dissent.

ii. The right to appoint an administrator to revive an insolvent chargor, if the chargee's charge is one on all or substantially all of the chargor's assets, and the debenture document empowers the chargee to appoint an administrator and receiver.

7.2 **Disadvantages**

7.2.1 In corporate finance and project finance, a floating charge generally ranks lower in priority than a fixed charge.

7.2.2 In corporate finance and limited recourse project finance, it may prove difficult and time-wasting for the receiver to possess relatively large

[25] Debentures differ from normal debts, debentures can be redeemable or irredeemable.
[26] Section 51 (5) Companies and Allied Matter Act, 2020; section 452 Companies and Allied Matters Act, 2020.

assets and carry out its duty to realise the debt which the charged assets secure.

8. Conclusion

A charge, which entails a borrowing company(chargor) using its asset(s) to secure a debt owed to a creditor(chargee), gives the chargee proprietary interest in the charged asset. This proprietary interest may be fixed on or floated over the charged asset(s). It is to the benefit of the chargor if he agrees with the chargee to float the charge. This is because, the chargor can still utilise the charged asset in the ordinary course of its business or create subsequent security over the charged asset without the consent of the chargee. For the chargee, making a decision between a fixed charge or floating charge comes with equal advantages and disadvantages. The chargee must assess this and select either a fixed or a floating charge, depending on which aligns with its business interests, goals and risk tolerance.

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