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Float like a butterfly, sting like a bee: is your floating charge valid?

In the current times of financial stress, a borrower seeking to renegotiate or refinance existing financing arrangements may be asked by a lender to enhance or refresh its security package through the grant of a new floating charge.

The question of whether a floating charge can be avoided due to section 245 of the Insolvency Act 1986 ("**IA 1986**") can arise in such a context.

Void floating charges under section 245 of the IA 1986

Unlike a fixed charge, which fixes on a specific asset and restricts the ability of the company to deal with that asset, a floating charge floats over a certain class of assets, such as cash or stock that is traded in the ordinary course of the company's business. These assets, by nature, are moveable or change from time to time.

Section 245, IA 1986 applies only to floating charges. It specifically addresses the issue of a creditor benefitting from a new floating charge for existing debt where no new consideration is provided. It forms part of a wider objective of the IA 1986 to ensure that certain creditors cannot receive preferential treatment from a company that is at risk of, or already on the verge of, insolvency.

A floating charge will be avoided under section 245, IA 1986 if the following conditions apply:

1. The floating charge is created within one year (or two years for any floating charge created in favour of a connected person) of the onset of the company's insolvency. In the case of administration, the precise point at which the "onset of insolvency" occurs will depend on the manner in which the administrator is appointed. Where a company goes into liquidation the onset of insolvency will be the date of the commencement of the winding-up.
2. At the time the floating charge was created, the company was unable to pay its debts or became unable to pay its debts in consequence of the transaction under which the charge was created (unless the charge was created in favour of a (then) connected person, in which case, there is no such requirement).
3. No new consideration was provided by the company at the time of, or after, the creation of the floating charge.

Although the starting point is that a floating charge will be invalid if it satisfies the conditions set out under 1 and 2 above, section 245(2), IA 1986 provides an exception to the extent of value given in consideration at the same time as, or after, the grant of the floating charge. It is therefore probably unsurprising that several court decisions have examined the nature and timing of the consideration provided for the floating charge – most recently in the case of *Manning v Neste AB*[1] .

Do you have valid consideration for a floating charge? Key points to consider

1. Consideration can take many forms

Under section 245(2), IA 1986, "consideration" can comprise:

(a) moneys paid or goods or services supplied;

(b) the discharge or reduction of any debt of the company; and

[1] [2022] EWHC 2578 (Ch)

(c) interest that is payable on the amount of such consideration under limbs (a) or (b) above.

In *Manning v Neste AB* it was held that the transfer of shares could constitute consideration for these purposes.

The court confirmed that the term "goods" in section 245(2), IA 1986 should not be limited to the ordinary legal meaning of goods in section 61 of the Sale of Goods Act 1979 ("all personal chattels other than things in action and money"). It could also cover things in action (such as money receivables) and intangibles (such as intellectual property) *"which are of a kind which (a) are received by the Company pursuant to its ordinary trading activity and (b) have a clear value, such that transfer of their ownership to the Company necessarily swells the assets of the company".*

2. Timing is everything

Parties should ensure that any consideration is provided at the time of or after the creation of the floating charge. The courts have applied a literal and strict interpretation of this timing requirement and the Court of Appeal has previously confirmed that the exception under section 245(2), IA 1986 will not be satisfied if *"the making of the advance precedes the formal execution of the debenture by any time whatsoever, unless the interval is so short that it can be regarded as de minimis—for example a 'coffee break' ".*[2]

In *Manning v Neste AB* a question also arose over whether the consideration was provided at the point at which the sale and purchase agreement for the shares was exchanged or the point at which the shares were actually transferred.

Following the reasoning in previous court decisions, the court rejected the notion that consideration under the IA 1986 would be determined by the ordinary contractual law principles that consideration is provided on the exchange of contractual promises. For section 245, IA 1986 purposes consideration should instead be used in a "non-technical sense" and viewed as "the point at which valuable property or services were in fact transferred". In the context of a financing scenario, the court explained it as follows:

"It is equally clear that if a financing proceeds in three stages; first the making of an agreement to provide finance and to grant a charge, second the granting of the charge, and third the payment over of the promised financing, the requirements of s.245 would be satisfied even though neither the making of the payment nor the granting of the charge would, in contractual terms, constitute "consideration"."

3. Approach any refinancing or renegotiation with caution

A financially stressed borrower may wish to renegotiate or refinance existing financing arrangements and in negotiations a lender may make it a condition that its security package is enhanced through the grant of a new floating charge.

In these circumstances, without due and proper analysis of the impact of section 245, IA 1986, creditors can get stung. It is therefore important for creditors to ensure that the grant of a new floating charge is made in exchange for new resources being made available to the company.

On any refinancing or renegotiation, any reduction in any existing debt that is agreed by the creditor in exchange for the grant of a floating charge by the company must not result in the company merely incurring new debt of similar value to the amount that has been reduced.

In *Manning v Neste AB* the judge observed:

"It seems to me that where a creditor of a company agrees to reduce or extinguish a money claim on that company as part of a transaction whose consequences are that it will acquire a new claim on that company of roughly equal value, that reduction or extinguishment will not constitute consideration for the purposes of s.245…".

The judge pointed out that any exchange transaction where a company's liabilities on existing debt are extinguished, but only on condition that the company becomes liable for a new debt to the same creditor will fail this test. This is not due to the exchange, but the "automaticity" of the process. The issue will arise when the terms of the transaction place the company in a position where incurring the new debt is the necessary price of being released from the old debt.

[2] Re Shoe Lace Ltd [1993] BCC 609 (also known as Power v Sharp Investments)

The judge in *Manning v Neste AB* also looked at whether renegotiation of an existing arrangement could constitute consideration for the purposes of section 245, IA 1986. The court determined that renegotiating the arrangements would not constitute new consideration as the conduct of the parties could simply not be construed as the provision of services.

The key test for this is whether the result of the arrangements is an increase in the amount of assets available for creditors[3]. However, where there is no more than a renegotiation of an existing arrangement, and there is no immediate material benefit to the Company from the renegotiation, then there is no new consideration.

If you have questions or need advice on any of the issues addressed in this article we would be delighted to help. Please contact one of the authors or your usual contact at Stephenson Harwood.

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[3] Parker J in Re Orleans Motor Company

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