

Banking Department

# A win for businesses as Banks' readiness to lend may increase?

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### Introduction

The recent Supreme Court ruling which provides greater protection to banks may have a positive impact on businesses in Ireland which rely on secured lending to raise capital.

The decision of the Supreme Court in *J. D. Brian Motors Limited t/a Belgard Motors (in Liquidation)* (and related companies) confirmed that preferential creditors will now rank below a floating charge holder where the floating charge has crystallised by notice in writing served on the company by the charge holder in the event of a winding up. The impact of this for banks is that their ability to serve a crystallisation notice on the chargor prior to the appointment of a liquidator protects their position.

### Background

The Belgard Motors Group of companies entered into three debentures with the Governor and Company of Bank of Ireland in 2005 each containing a clause to the effect that the bank may, at any time, by notice in writing served on the companies, convert the floating charge into a fixed charge where the assets were considered to be in jeopardy. The bank issued a crystallisation notice in October 2009, per the terms of the charging document. A winding up order was made in respect of the group of companies by the High Court in December 2009 and Tom Kavanagh was appointed by the Court as the Official Liquidator. The Official Liquidator subsequently applied to the High Court for directions pursuant to Section 280 of the Companies Act 1963.

### High Court Ruling

In two separate decisions in 2011 which left lending institutions in a precarious position, the High Court diverged from the English stance on the issue. Section 285(7), which concerns the treatment of preferential creditors in a winding up, provides that they will take priority to the claims of holders of any floating charge. The Judge held that a crystallisation of a floating charge into a fixed charge before the liquidation event is not sufficient to supersede the priority of preferential creditors. The Judge stated:

*"... in my judgment the proper meaning of s. 285 (7) is that the preferential debts rank in priority to the claim of the Bank, as debenture holder, to the funds realised from the assets subject to the floating charge pursuant to clause 5 of the debenture, irrespective of whether the floating charge crystallised prior to the commencement of the winding up"*

### Appeal

The matter was appealed by the liquidator to the Supreme Court which set aside the declarations of the High Court. The Supreme Court ordered that the floating charges which had crystallised into fixed charges prior to the winding up were to rank in priority to the preferential debts owed by the companies. The Court suggested that if it had been intended that the holder of a crystallised floating charge would lose priority for its claims to the priority debts, then the Oireachtas would have so provided.

### Conclusion

The consolidated Companies Act which came into force in June of this year has transposed the wording of Section 285 (7) directly, meaning that in the absence of amending legislation, the position will remain unchanged. The Official Liquidator has stated that he expects to see this having *"...a positive impact on banks' willingness to lend to the many viable Irish businesses who need support in terms of their working capital position."* The Supreme Court did empathise however with the concerns of the Revenue Commissioners that a debenture holder could effectively "leapfrog" over preferential creditors such as themselves with the possibility of serving a contrived crystallisation notice and has

stated that “...it does appear that the replacement of s. 285(7), s. 621(7) of the Act of 2014, requires to be amended to reverse the undoubtedly unsatisfactory outcome of this decision, which gives rise to a number of concerns”.

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