

The Basics on Securities: What are Charges and what do they do?

October 2022
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1. Introduction

When proceeding in a business venture, ensuring a streamline of finances is vital to any such venture. There are times whereby obtaining such finances poses a challenge to such a business, to which there are various ways in responding to such challenges. Obtaining a debt is



being one of them. In the local regime, charging of a property is a common way in providing security towards such debt. With that in mind, we shall attempt to provide an overview on what a charge is, the two types of charges that are commonly used (ie: fixed charge and floating charge), and certain practical points.

2. What is a Charge?

A charge refers to the collateral, given for securing the debt, by way of mortgage on the company's or an individual's assets. The party providing the charge is a "chargor" while the party benefiting from the charge is called a "chargee" Unfortunately, there no one specific statutory definition on what a charge is, as it is based on context. Having said that, the most common reference is made to the National Land Code and the Companies Act 2016. The two statutes are often read together, as in practice, parties that would need extensive funding will end up being body corporates.

Under the National Land Code, which is the core statute for real estate regulation in the country, it provides that "*every charge created under this Act (ie: the National Land Code) shall take effect upon registration so as to render the land or lease in question liable as*

*security in accordance with the provisions thereof, express or implied*¹. On the other hand, in the event the chargor is a company, then Sections 352-364 of the Companies Act 2016 shall apply. It should be noted that in the Companies Act 2016, charges can be made towards other properties beside real estate, such as stocks, equipment, and other tangible or intangible property². In the event that the charged property is not a piece of real estate, then the National Land Code would not apply.

The above explanation is usually read alongside case law. In the case of *National Provincial Bank of England v Charnley*³, an English case which is relied in the local courts⁴, has held the following conditions are to exist to create a charge:

- An intention of the parties that the property (existing or future) shall be made available as security;
- It is security for the payment of debt; and
- And the creditor has the right to have made it available, even though the creditor has no legal right on possession.

It should be noted that individuals can also charge their property. Having said that, it is incredibly rare for individuals to have high-value property beyond real estate. In practice, security provided by an individual will be usually under a personal guarantee, which operates like a floating charge (whereby how a floating charge works will be discussed later).

In normal conversations, a charge is sometimes referred to as a mortgage and the two words sometimes are used interchangeably. Although both mortgage and charge have the same function and outcome (being a method of security and the failure of repayment will result in possession of property that was used as security), the principles behind them are different. In the case of a charge, only the interest is transferred to the chargee; the ownership remains with the chargor. In the case of a mortgage, both the interest and ownership are with the mortgagee and the mortgagor only has a right to redeem the land back upon full payment⁵. This confusion probably stems from the impression that being a common law country, the Malaysian legal system is based on the English legal system.

¹ Section 243 National Land Code

² Section 252 Companies Act 2016

³ [1923] All ER Rep Ext 820

⁴ *NGV Tech Sdn Bhd (receiver and manager appointed) (in liquidation) v Ramsstech Ltd* [2015] MLJU 671

⁵ *Sivadevi a/p Sivalingam v Cimb Bank Bhd* [2018] MLJU 521

This is a correct assumption under most circumstances, save for charges. This is because the concept of charges, in particular under the National Land Code is sourced from the Australian Torrens system and not English land law. As such, it is common to have mistaken a loan security of a property as a mortgage instead of a charge due to this cultural impression.

It should also be noted that are laws on charges in England. Depending on the situation, a business can choose either mortgage or charge. As a result, there is a pre-existing body of law in England on charges, as referred to in the case of Charnley above. However, for Malaysian businesses or individuals, the option for getting a mortgage is not there. It is worth pointing out that references to the word “mortgage” in the Companies Act refers more to the common literal meaning than the legal meaning like in England.

3. What is the Difference between a Floating Charge and Fixed Charge?

We now turn our attention to the types of charges. A floating charge is a security given by a company to a charge to secure certain debts. It is usually incorporated in a debenture and is commonly created to cover a range of tangible and intangible assets of the charge. Such assets may consist of stock in trade, raw materials, equipment, cash in hand, book debts and shares. Naturally, the charge would cover the entire business of the company. By its nature, the floating charge can include future assets that have yet to exist when the charge was created. A fixed charge on the other hand, is the total opposite. There is no range of assets to begin with and what is charged is a specific fixed asset or sets of assets which have been already identified.

How parties decide to choose which form of charge will depend on the type of financing is required and the business model of the charge. As an example, it will make more sense for a chargee publication house, to have a floating charge to include future copyrighted material, or a manufacturing company who will build more equipment in the future. On the other hand, a fixed charge may be more practical if the chargee is already asset-rich and a specific building or plot of land is held on charge as piece of security.

There is no specific statutory definition for the type of charges, although there are sections in the Companies Act 2016 that governs its application. As such, reference is again made to case law. In the case of *Illingworth v Houldsworth*⁶ from England which has also been relied on locally⁷ has held that a fixed charge (referred to as a “specific charge” in this case) is one that locks on “ascertained and definite property or property capable of being ascertained and defined”. In this case, a floating charge is stated to be shifting in its nature and “seem as floating with the property” until some event occurs that causes it to settle and fastens on the subject of the charge⁸. The process of settling is often called “crystallization”.

As required under Section 353(g) of the Companies Act, it states that the floating charge is a type of charge that must be registered with the Companies Commission of Malaysia, also known as “Suruhanjaya Syarikat Malaysia” in Bahasa Malaysia. An individual would not have such registration obligation, although they may be subject to certain “know-your-client” protocols of the financial institutions they are dealing with.

It should be noted that a fixed charge will always have priority over a floating charge regardless of the date of creation of their charge towards the same chargee. The reason is because a floating charge operates in equity and the rights of the charge is in essence, still dormant⁹. However, the rights pertaining to a fixed charge is already fixed, since the property charge is already determined. It has a legally binding force at the very beginning. For a floating charge to be treated as a fixed charge, the crystallization process has to take place first¹⁰. This situation will of course be different if both floating and fixed charges are not “*pari passu*” which essentially means two different parties of similar legal footing or priority. And in these case, two charges of equal footing. If the charges are not *pari passu*, then parties would have to rely on the specific drafting of such charges to properly ascertain the priority the same, which can open up legal risks. Careful drafting is strongly advised to avoid such conflicts on the priority of charges.

⁶ [1904] AC 355

⁷ *Re Lin Securities (Pte) Peter Chi Man Kwong and 2 others v Asia Commercial Bank and 20 others* [1988]2 MLJ 137

⁸ [1904] AC 355 at p 358

⁹ *Affin Bank Bhd v Malayan Banking Bhd* [2009] 2 MLJ 74

¹⁰ *ibid*

4. Crystallization of a Floating Charge

The debenture for the floating charge usually defines a series of events stating that upon occurrence of any of the events, the charge will crystallize into a fixed charge. The chargee will then have the option to enforce the charge. This means that parties have the liberty in deciding what sort of event of defaults or condition precedent that need to be fulfilled for the crystallisation to happen. In the event that a dispute based on this has proceeded to the courts, it will most likely be dealt with like any other contractual litigation before it.

5. The End of a Charge

5.1 Charge under the National Land Code

If a debt is defaulted, then the process pertaining to the enforcement of a charge will depend of course on the instrument that is involved and the property that was charged. If the legal charge is registered under the National Land Code, it can be enforced by obtaining an order for sale via Section 256 of the National Land Code either from the High Court or the Land Administrator if it is a Land Office title under Section 260 of the National Land Code. Under the National Land Code, a “registry title”¹¹ refers to townlands, village lands, country lands or any land with more than 4 hectares of size and “Land Office Title”¹² is defined as a plot of country land that shall not exceed 4 hectares in area or size.

Additionally, a chargee may at any time when the chargor is in breach of any agreement on his part expressed or implied in the charge, enter into possession of the whole or any part of charged land¹³ by forwarding a form to the Chargor called “Form 16K: Notice Of Entry Into Possession”. This form shall stipulate a date to which the sum owed is to be paid and failing which will allow the Chargee to apply to the Courts for an order for possession¹⁴. However, this right to possess is only limited to the first charge¹⁵ and cannot be enforced on a Land Office title¹⁶.

¹¹ Section 77(3)(a) National Land Code

¹² Section 77(3)(b) National Land Code

¹³ Section 271(1) National Land Code

¹⁴ Section 272(3) National Land Code

¹⁵ Section 270(2) National Land Code

¹⁶ Section 270(1)(a) National Land Code

This order for possession literally means the court order to possess the property. It will allow the chargee to take over the land that was charged. This will last so long as the land is subject to the liability of the charge¹⁷. Usually, the reasoning behind this possession is to obtain the rentals of tenants who occupy said property and to strong-arm the chargor to remedy the breach of the loan agreement connected to the charge. In short, the chargee has control of the land like a landlord but not real ownership. For the possession of the title and obtaining real ownership of the property in question, an order for sale would be necessary. Alternatively, it is possible to enter into an sale and purchase between chargee and chargor and view it as a dissolution of the charge. Of course, this would be tricky if other chargees are involved.

5.2 Charge under a Debenture

If the charge created under a debenture (ie: a fixed charge or floating charge) it can usually be enforced by the appointment of a “receiver” or “receiver and manager”. A “receiver” refers to a person who receives rents or other income, paying ascertained outgoings; but he does not manage the property in the sense of buying and selling anything of that kind¹⁸. A “receiver and manager” has all the powers of a receiver and additionally of a “manager”¹⁹, who has the authority to carry on the trade or business of the company. This explanation alongside Schedule Six of the Companies Act, whereby it provides for the powers of a receiver or a receiver and manager. Among the powers that are provided is the authority to take possession and control of the property of the company in question²⁰, to lease, let hire or dispose of the assets of the company²¹, and to demand and recover income of the property of receivership²². It should be noted that although case law has provided the difference between a “receiver” and “receiver and manager”, in practice they are both one and the same, as both are given the same authorities under Schedule Six and that almost all sections in the Companies Act that makes reference to them refer to both “receiver or receiver and manager”. As such, it is safe to say that save for a historical standpoint, both the “receiver” and “receiver and manager” in current practice, is one and the same.

¹⁷ Section 273 National Land Code

¹⁸ Re Manchester & Metford Railway (1880) 14 Ch D 645

¹⁹ *ibid*

²⁰ Item 2(a) Sixth Schedule of the Companies Act 2016

²¹ Item 2(b) Sixth Schedule of the Companies Act 2016

²² Item 2(j) Sixth Schedule of the Companies Act 2016

With regard to the appointment of a receiver or receiver and manager, it must be done either via the Court²³, or under an instrument²⁴. If the appointment is via an instrument, such instrument must clearly state that such rights of appointment are present²⁵. In cases of compulsory winding up which requires the court's involvement, the court would appoint said receiver/ receiver and manager under Section 478 of the Companies Act 2016 and in accordance with Rule 46 of the Companies (Winding Up) Rules 1972. Rule 46 clarifies that the person appointed as liquidator (ie: the receiver and manager) would generally be on recommendation and determination of the official receiver, creditors and contributories via a meeting amongst the aforesaid parties. As such, this is a formal appointment by the courts, but behind the scenes it would have been the creditors that initiate said appointment.

In the case of Abdul Rahman bin Ismail v Pembangunan Qualicare Sdn Bhd (Penang High Court Winding Up Petition No. 28-6-01/2013), the High Court was faced with two competing nominations, from different creditors. The court hearing the matter suggested commencing a mini trial to ascertain the validity of the nominations of the parties in order to decide which of these nominated liquidators was to be appointed.

It should be noted that a debenture can also include real estate as a property to be charged. In relation to the security over bank accounts or fixed deposits by way of an assignment, a fixed charge, or a combination of both, lenders can exercise their rights of set-off under the relevant security documents to set off the debts owing to the lenders. If shares are involved, then the necessary transfer processes from the chargor to chargee be necessary. If the transfer was not actualized, the chargor can use this as a cause of action for a judgment against the chargee to compel the transfer. In the end, the method of enforcement greatly depends on the instrument and the property that was charged, as mentioned earlier. As such, the drafting of the debenture has to be done correctly and without any ambiguity.

5.3 Fulfilment of Charge

However, if the debt has been fulfilled, then the charge has served its purpose. In the event that the charge is based on a registered charge under the National Land Code, then the chargor can proceed in getting the charge removed, via a process called a

²³ Section 374(c) Companies Act 2016

²⁴ Section 374(a),374(b) Companies Act 2016

²⁵ *ibid*

discharge of charge²⁶. If the property charged was charged via a debenture and a corporation is the chargor, then the chargor is required to inform the Registrar on the fulfilment of the debt²⁷.

6. Conclusion

We hope that the information shared has provided a general idea on what charges are and how they work. However, there are various moving parts in a charge and the needs of each corporation will differ when it comes to such processes. Due to this, the scenarios provided above is non-exhaustive. In the event that you would like to know about what was shared in greater detail, please do not hesitate in contacting us.

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²⁶ Section 278 National Land Code

²⁷ Section 360 Companies Act 2016



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