

Irish Supreme Court Strengthens Lenders' Security

A clear view

Warren Baxter comments on the implications for banks following the Irish Supreme Court's ruling in the Belgard Motors case.

Irish lenders received a major boost from the country's highest court in its recent decision on the Belgard Motors case.

The three Supreme Court judges unanimously decided that Bank of Ireland had successfully managed to crystallise its floating charge against Belgard Motors, into a fixed charge. This has allowed the bank, as the charge holder, to gain priority over the company's preferential creditors in relation to receiving the proceeds of the affected assets.

In Ireland preferential creditors are primarily made up of state agencies, such as the Revenue Commissioners. Under Irish law preferential creditors are given priority over floating charge holders. Such liabilities in an insolvent company can often be very large, with the result that preferential creditors frequently make up a significant proportion of its liabilities. This, in turn, reduces the effectiveness of banks' floating charges.

Background To The Case

In late 2009 three companies, which were part of the Belgard Motors Group, were put into liquidation and Tom Kavanagh of Deloitte was appointed liquidator by the High Court. Prior to Tom Kavanagh's appointment each of the three companies had entered into debentures with Bank of Ireland. Each of these debentures included a clause stating that the bank may, by notice in writing, convert the floating charge into a first fixed charge over all the property, assets and rights subject to the floating charge. This crystallisation notice was invoked by the bank shortly before the companies were wound up.

In June 2010 the liquidator applied to the High Court for directions, seeking confirmation that the floating charges had validly crystallised. The High Court ruled that the companies' preferential debts ranked in priority to the bank's floating charge, irrespective as to whether the floating charge had crystallised prior to the liquidation.

The liquidator, with the support of the bank, appealed the High Court's decision to the Supreme Court. In the appeal submissions were made by the

liquidator and the bank, as well as by the Revenue Commissioners, who effectively acted as respondents to the appeal.

The Decision

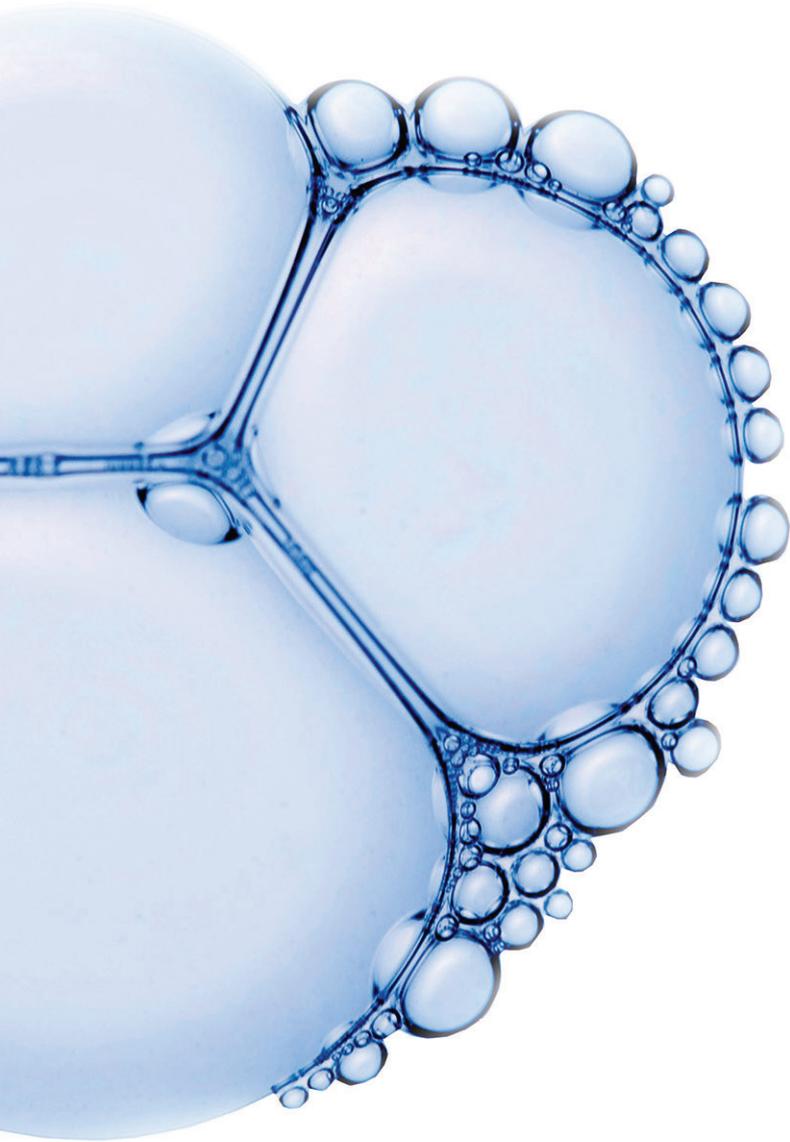
After considering the arguments for and against, the Supreme Court issued an order allowing the appeal and went on to state that the floating charges created by the debentures had, in fact, converted into fixed charges by virtue of the bank's crystallisation notices. The Supreme Court went on to say that the claims by the bank, as a debenture holder of the funds realised from the assets subject to the floating charges, ranked in priority to the companies' preferential debts.

Interestingly, in her judgment Ms. Justice Laffoy went on to say that it Section 621(7) of the Companies Act, 2014, which sets out the priority of preferential creditors over floating charge debenture, "requires to be amended to reverse the undoubtedly unsatisfactory outcome of this decision" and went on refer to this judgment giving rise to "the current unsatisfactory legislative position".

The Impact

As a result of the decision lenders in Ireland now know that they can convert floating charges into fixed charges with confidence under certain conditions. Firstly, they should ensure that their debentures include a valid crystallisation clause and, secondly, they ensure that notice is properly served prior to the winding up of the company which the debenture is held against. One positive aspect of this ruling is that now lenders' loan security has been significantly strengthened, banks should be able to increase their lending to trading businesses, many of which have struggled to raise funds in recent years.

However Irish lenders will need to bear in mind that the Supreme Court has also made it clear in its judgment that it is unhappy with the way the law now stands and that the government, whose agencies represent most preferential creditors, may bring in new legislation designed to prevent the ability of lenders to crystallise floating charges in such circumstances.



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