



# Existing without Equity: is the floating charge a successful importation in China?

by Lei Zhang

---

## Abstract

Modern commercial transactions require more on financial security mechanism where debtors offer personal property to secure debts advanced by creditors. Security mechanism enables creditors to control loan risks and consequently lowers the cost of credit to debtors. To ensure their proprietary interests effective and enforceable in the insolvency process, creditors seek to create secured rights more widely and flexibly over loaned assets; while at the same time, debtors hope to remain the disposal of assets despite of the secured interest. The floating charge is a form of security that meets this demand. It allows creditors to obtain proprietary rights over present and future assets; meanwhile, debtor companies could continue their business with charged assets.

As China was striving to develop a coherent and comprehensive financial system corresponding to the worldwide financial boom, a completely new security system has been established in the last three decades. The promulgation of Chinese Property Law 2007 included substantial and significant clarification of security interests that could be created, among which the introducing of the floating charge was indeed a breakthrough. The importation of the floating charge was contemplated to improve the financing ability of companies and therefore accelerate the financial liquidity in Chinese market economy. It was expected to facilitate the development of privately-owned small and medium enterprises under “policy-lending” context, where the Chinese government controlled bank lending mainly towards state-owned enterprises. However, those conceptual advantages can only be achieved if the floating charge can operate in the host legal environment efficiently and harmoniously. Since the floating charge is a product of equity, there are many problems faced by Chinese legislators. Hence, this paper attempts to examine this innovation and submit it to critical analysis.

## 1. Introduction

Modern commercial transactions require more on financial security mechanism where debtors offer personal property to secure debts advanced by creditors. Security mechanism enables creditors to control loan risks and consequently lowers the cost of credit to debtors. To ensure their proprietary interests effective and enforceable in the insolvency process, creditors seek to create secured rights more widely and flexibly over loaned assets; while at the same time, debtors hope to remain the disposal of assets despite of the secured interest. The floating charge is a form of security that meets this demand. It allows creditors to obtain proprietary rights over present and future assets; meanwhile, debtor companies could continue their business with charged assets.<sup>1</sup> Derived from England, the floating charge is indeed a genius invention in the era of enormous industrial expansion and increased capital demands.

---

<sup>1</sup> G. F. Curtis, ‘The Theory of the Floating Charge’ (1941) 4 UTLJ 131, 133.

As China was striving to develop a coherent and comprehensive financial system corresponding to the worldwide financial boom, a completely new security system has been established in the last three decades. The promulgation of Chinese Property Law 2007 included substantial and significant clarification of security interests that could be created, among which the introducing of the floating charge was indeed a breakthrough. The importation of the floating charge was contemplated to improve the financing ability of companies and therefore accelerate the financial liquidity in Chinese market economy. It was expected to facilitate the development of privately-owned small and medium enterprises under “policy-lending” context, where the Chinese government controlled bank lending mainly towards state-owned enterprises.<sup>2</sup>

However, those conceptual advantages can only be achieved if the floating charge can operate in the host legal environment efficiently and harmoniously. Since the floating charge is a product of equity, there are many problems faced by Chinese legislators. Hence, this paper attempts to examine this innovation and submit it to critical analysis. The arguments are divided into three parts. After introduction and methodology, part three seeks to explain the nature of the floating charge in England. In this part, I will conceptualise the floating charge by comparison with the fixed charge. Part four critically analyses the floating charge in Chinese law. The analysis will focus on whether or not the floating charge in China is of the same meaning as that in common law sense. Part five evaluates the importation of the floating charge in China. Chinese floating charge did not strike a good balance between safety and efficiency values. Finally, the conclusion is made that the importation of a new security device needs cooperation of the whole legal framework. Only with proper adjustment will Chinese law become more coherent and consistent.

## 2. Methodology

There are two main issues examined in this paper. First, how can the floating charge be incorporated into Chinese law in the absence of the concept of equity? Second, if incorporated, can it function effectively in the Chinese setting? To answer these questions, this paper adopts two main research approaches. The first one is the verification approach and the qualitative test of the hypothesis in the defined environment.<sup>3</sup> The nature of the floating charge and the efficiency of this legal framework are matters of debate. English law has historically developed and been well established in the floating charge system. The case law and statutes provide a rich resource for the work undertaken here. However, the newly-born floating charge in Chinese law, relatively speaking, lacks enough judicial practice that is essential to the assessment. Despite this problem, the enactment of statutes is the advantage of the statutory law system and does provide a sufficient basis for the analysis. The issue is thus mainly discussed from the aspects of statute provisions and bank practice in China. The second one is the comparative legal analysis that mainly focuses on “law-in-context” method.<sup>4</sup> Putting law in a specific context aims to understand the law and to explain why the law is as it is.<sup>5</sup> This is significant in assessing whether or not the floating charge fits well with commercial needs, because the security regime is only efficient if it can reduce the financial risk of creditors and promote asset utilisation in the host law system.

## 3. The Floating charge in England

The nature of the floating charge has continuously been controversial in both academic and practical areas. On the one hand, as is flexible, the floating charge attracts debtors to obtain loans without being deprived from the control over their assets. On the other hand, however, its disadvantages, such as the lower priority ranking of the floating charge in insolvency, decrease the

---

<sup>2</sup> Mark Williams and Haitian Lu, ‘Expanding Secured Credit for Firms in China: Is the Floating Charge an Appropriate Transplant?’ (2012) ExpressO [https://works.bepress.com/haitian\\_lu/1/](https://works.bepress.com/haitian_lu/1/) accessed 23 February 2018.

<sup>3</sup> Barney G Glaser and Anselm L Strauss, *The Discovery of Ground Theory: Strategies for Qualitative Research* (Hawthorne New York: Aldine De Gruyter 1967) 10-15.

<sup>4</sup> Rodolfo Sacco, ‘Legal Formants: A Dynamic Approach to Comparative Law’ (1991) 39 AJCL 343, 384.

<sup>5</sup> Mark Van Hoecke, ‘Methodology of Comparative Legal Research’ (2015) 12 Law and Method 1, 16.

equivalent attraction as to creditors. The effective and enforceable security interest in the insolvency process is of vital significance to creditors, while the efficient asset utilisation is more meaningful to debtors. The conflict of these interests frequently results in litigation that is induced by the creation of the fixed or floating charge.<sup>6</sup>

The conceptualisation of the floating charge becomes even more difficult when it is compared with the fixed charge. Judicial practice has indicated that courts are no longer satisfied with the three-characteristic definition in *Re Yorkshire*, which was considered to be the hallmark for the conception of the floating charge.<sup>7</sup> The problem lies in deciding how much freedom to deal with the property is consistent with the floating charge, a recurring issue especially manifest in cases concerning book debts. After *Siebe Gorman* and *Re Brightlife Ltd*, the floating charge was not the only security that can be created on future assets.<sup>8</sup> Debtor companies could also create a fixed charge for their creditors over future book debts. It was therefore argued that the characteristic of “present and future” and “changing” assets could no longer be the criteria to draw a line between the two.<sup>9</sup> If so, the essence of the floating charge becomes that the chargor can deal with charged assets freely in the ordinary course of business. If the chargor can continue its business and remain disposal of charged assets under the charge interest, then it will be characterised as the floating charge rather than the fixed charge.

However, the confusion was far away from being solved and was increased particularly by the judgement in *New Bullas*,<sup>10</sup> followed by the two landmark judgements in *Brumark* and *Re Spectrum Plus*.<sup>11</sup> *New Bullas* has been criticised on its decision that book debts and their proceeds could be separately charged. It was held that the charge on the uncollected book debts was a fixed charge while over their proceeds a floating one.<sup>12</sup> This decision was reversed then by the Privy Council in *Brumark*. The issue before the Privy Council was that since the company remained its right to collect debts and use proceedings without the consent of creditors, whether or not the charge on the uncollected debts was a fixed or floating one. The two-stage process was the key of this decision, which included first, “gathering the intentions of the parties” to “ascertain the nature of the rights and obligations”; and then, characterising in the matter of law.<sup>13</sup> The judge illustrated that “the proceeds were not at the company’s disposal”, because the company was required to pay the collected proceeds into a specified “blocked account”. But the court also held that “it is not enough to provide in the debenture that the account is a blocked account if it is not operated as one in fact”.<sup>14</sup> It meant that the bank needed to have the real and substantial control over the proceedings. This explanation was also applied later in *Re Spectrum Plus*. The security in this case was similar to that in *Siebe Gorman*. No restrictions on the chargor’s operation of that account were specified in the debenture. The company could draw on the account for business transaction. The court needed to decide whether or not the restrictions on the company’s disposal of the proceeds were sufficient to render the security as a fixed charge. The judge addressed that although the chargor company was demanded to pay the collected proceeds into a specific bank account, the overdraft facility was operated without any restrictions from the bank and there was no suggestion that the chargor needed to obtain consent from the chargee. The charge therefore was consistent with the nature of the floating charge.<sup>15</sup> That decision could also be made from the perspective of the chargee’s control over the uncollected book debts. Although in the debenture, there were some express restrictions on assigning the book debts,

<sup>6</sup> Ellis Ferran, ‘Floating Charges—The Nature of the Security’ (1988) 47 CLJ 213, 228.

<sup>7</sup> *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284 (CA) 295.

<sup>8</sup> *Siebe Gorman Co. Ltd v Barclays Bank Ltd* [1979] 2 Lloyd’s Rep 142; *Re Brightlife Ltd* [1987] 1 Ch 200 (Ch).

<sup>9</sup> Hugh Beale and others, *The Law of Personal Property Security* (OUP 2007) 132-33.

<sup>10</sup> *Re New Bullas Trading Ltd* [1994] 1 BCLC 485, [1994] BCC 36.

<sup>11</sup> *Agnew v Commission of Inland Revenue* [2001] UKPC 28, [2001] 2 AC 710; *National Westminster Bank plc v Spectrum Plus Ltd and others* [2005] UKHL 41, [2005] 2 AC 680.

<sup>12</sup> *New Bullas* (n 10).

<sup>13</sup> *Brumark* (n 11) [32].

<sup>14</sup> *ibid* [48].

<sup>15</sup> *Re Spectrum Plus* (n 11) [119].

no other restrictions prohibited the chargor from dealing with the book debts in the ordinary course of business. Therefore, the restrictions were insufficient for the chargee to create a fixed charge.

Characterisation of the charge is a matter of law, and the critical issue is “whether the restrictions imposed ... on the use that the chargor can make of the proceeds of the book debts charged are sufficient in law to create a fixed charge on those debts”.<sup>16</sup> If chargors have no right to use the proceedings with the terms of the debenture, then it is easy to characterise this as the fixed charge. Similarly, if chargors are completely free to make use of charged assets before crystallisation, then it is a floating charge. It is the intermediate case, in which the debenture imposes some restrictions on the chargors’ operation, but in the meantime, allows some kinds of disposal, that causes problems. Unfortunately, most charges in practice fall within the intermediate group, since the contract is always the acceptable compromise between the two parties’ interests. It was indicated that the third characteristic in *Re Yorkshire* could still distinguish the floating charge from the fixed one. The court was continuously exploring that to what extent the disposal power is enough to preclude the intervention of the chargee. The implications of *Re Spectrum Plus* provide two key issues for future characterisation of charges, namely “control” and “commercial realism”.<sup>17</sup> Characterisation depends on the “commercial nature” and ‘substance’ of the agreement.<sup>18</sup> It means that the label described in the charge instrument is not necessarily decisive. What really matters are the permanent control by the chargee over assets and whether or not such control is exercised.<sup>19</sup> This is in line with *Brumark* that the blocked account is “not enough” if “it is not operated as one in fact”.<sup>20</sup> Indeed, the control requires a close examination of the charge instrument, not by a “post contractual analysis” of parties’ conducts, but by the established contractual interpretation rule.<sup>21</sup> The intention of the parties should be inferred from the arrangement in contractual terms. This is perhaps a reference to the two-stage process in *Brumark*. Besides this, *Re Spectrum Plus* also emphasizes the legal significance of parties’ action after the conclusion of the contract.<sup>22</sup> Thus accordingly, if the inferred intention of the parties is to impose restrictions ostensibly to create a blocked account while they do not act so in practice, the intended fixed charge will not be created. The charge created, in law, is a floating charge. *Re Spectrum Plus*, in this sense, returned a degree of certainty to the law on the distinction between the fixed and floating charge. However, the power to continue trading is not necessarily unlimited.<sup>23</sup> The company only has the freedom to carry on “in the ordinary course of business”.<sup>24</sup> If the debtor company acts without authority and that action causes crystallisation of the floating charge, then the relevant third party may also be liable for the unauthorised transaction.<sup>25</sup> While if the action of the company, though beyond the trading power, does not affect the company’s business, the chargee does not have a proprietary interest against the third party.<sup>26</sup> In this context, English law imposes a wide trading power on chargors to continue their business.

#### 4. The Floating Charge in China

In China, the rules concerning the operation of the floating charge are governed by legislation and related judicial interpretations. Prior to the enactment of the Property Law in 2007, the Security Law 1995 governed security rights over property.<sup>27</sup> Like in common law situation, without the concept of the floating charge, a Chinese mortgagor “shall not transfer the property under mortgage during the

---

<sup>16</sup> *Re Spectrum Plus* [2004] EWCA Civ 670 [86].

<sup>17</sup> Catherine Addy, ‘Fixed and Floating Charges over Book Debts—the Implications of the House of Lord’s Decision in *Re Spectrum Plus Limited* [2005] UKHL 41, Part I’ (2010) Special Issue International Corporate Rescue <http://www.chaseambria.com/site/journal/special/issue.php?id=23> accessed 23 February 2018.

<sup>18</sup> *Re Spectrum Plus* (n 11) [116].

<sup>19</sup> Addy (n 17) 16.

<sup>20</sup> *Brumark* (n 11) [48].

<sup>21</sup> *ibid* 17.

<sup>22</sup> Alan Berg, ‘The Cuckoo in the Nest of Corporate Insolvency: Some Aspects of the Spectrum Case’ (2006) 1 JBL 22, 22.

<sup>23</sup> Ferran (n 6) 229.

<sup>24</sup> *Re Yorkshire* (n 7).

<sup>25</sup> Ferran (n 6) 234.

<sup>26</sup> *ibid*.

<sup>27</sup> 1995 Security Law c IV.

mortgage term without the mortgagee's consent".<sup>28</sup> Inconvenience arose in practice especially when floating assets were involved. The floating charge was consequently introduced to grant the security over circulating assets and facilitate the use of the charged property in commercial transactions. This was the same rationale that justified the development of the floating charge in England in the 19<sup>th</sup> century.

Article 181, 189 and 196 in the Property Law 2007 embody the floating charge, which are stipulated in Part Four "Secured Property Rights" under Chapter XVI "Right to Mortgage". The "mortgage" in China can be granted over personal properties without the transfer of title and possession from the mortgagor to mortgagee.<sup>29</sup> To some extent, the "mortgage" in Chinese law is more like a common law fixed charge, whereby the chargee obtains the security interest with no transfer of title or possession of secured assets. This may explain the reason why the floating charge was stipulated in the chapter "Right to Mortgage". However, this arrangement also leads to some confusions. Does the new provision in Article 181 create a floating charge in common law sense, or just extend the scope of the existing "mortgage" (fixed charge in common law sense)?<sup>30</sup> To answer this question, the statutory language is not necessarily determinative. What really matters is the essence of this specific security device. Again, the starting point of the examination is the three characteristics of the floating charge mentioned in *Re Yorkshire*.

#### 4.1 Provisions in the Property Law 2007

Firstly, Article 181 of the Property Law 2007 provides that the parties upon the written agreement can "mortgage existing and future" property that includes "equipment, raw materials, semi-finished and finished products". Although the scope of the provision is limited as intangible assets are not included, the nature shares the similarity with the first characteristic of "present and future". Secondly, the secured object of "equipment, raw materials, semi-finished and finished products" has a common nature of floating, which "would be changing from time to time". A further persuasive argument would be derived from Article 196, which lists the four circumstances in which the property under security shall be "determined". Upon determination, assets underlying the security can no longer float in value, and the chargee shall be entitled to realise the secured right and "seek preferred payments from such properties".<sup>31</sup> That resembles a lot with the meaning of "crystallisation" in common law sense. The security right in the Property Law 2007 relates to the moment when the secured property is determined, or, in common law terms, the time when the charge attaches to the asset.<sup>32</sup> As to the third and most essential characteristic, namely "the company may carry on its business in the ordinary way", however, there are some ambiguity deriving from the statute. Article 189(2) provides that registered creditors as prescribed in Article 181 "shall not challenge the buyer which has paid a reasonable price in normal business operations and has obtained the property under mortgage." This distinguishes the floating chargee from the general mortgagee since the former has limited control over charged assets. From the perspective of debtors, Article 189(2) means that they can freely dispose of charged assets in the ordinary course of business. However, an argument against the free disposal is that Article 191 potentially casts some doubts as to the extent of the "liberty" to deal with charged assets.<sup>33</sup> It states that without the mortgagee's consent, the mortgagor shall not transfer the mortgaging property, unless the third-party pays off the debts on the mortgagor's behalf. Based on this provision, it was argued that Article 191 adversely affected the chargor's liberty to dispose of charged assets under Article 189. However, Article 191 is the general rule that applies to general mortgages, while Article 189 is the special rule intended for the floating charge. When there is a conflict between the two, the special provision must prevail over the general rule. Therefore, the floating charge should be bound by Article 189.

<sup>28</sup> 2007 Property Law, art 191.

<sup>29</sup> 2007 Property Law, art 179.

<sup>30</sup> Mark Williams, Haitian Lu and Chin-aun Ong, *Secured Finance Law in China and Hong Kong* (CUP 2010) 73.

<sup>31</sup> 2007 Property Law, art 179.

<sup>32</sup> Williams, Lu and Ong (n 30) 73.

<sup>33</sup> *ibid* 74.

However, as mentioned before, the floating charge provisions were placed in the sub-section one of “General Right to Mortgage” under the chapter “Right to Mortgage”. Even though the “mortgage” in Chinese Property Law 2007 does not necessarily have the same meaning as the mortgage in common law sense, the provisions were certainly not randomly arranged. The scheme of the regulations should be made with some implications. Being established over future assets is not the substantial distinction between the fixed charge and the floating charge. What really distinguishes them is that with the floating charge, the chargor has the freedom to dispose of assets in the ordinary course of business. If we treat the Chinese mortgage in substance the same as the fixed charge in common law sense, the issue then becomes that to what extent Article 189(2) provides the chargor with freedom to deal with charged assets and that to what extent the chargee has control over these assets.

#### 4.2 Assets to the Floating Charge and the Trading Power

As stipulated in Article 189(2), the chargor can use assets without obtaining consent from the chargee, but this utilisation must be taken place “in normal business operations” and with “a reasonable price”. These are restrictions for the chargor’s disposal of charged assets. Theoretically, both vital civil law professors adopted a limited interpretation of “normal business operations”. Wang argued that “normal business operations” should be limited to transactions involving the transfer of ownership or other rights in legitimate transactions. This is because the statute only specifies the “buyer”, which apparently precludes mortgagees, lien holders and other parties to non-trading activities.<sup>34</sup> Similarly, Liang held that “normal business operations” only refers to the sale of products to consumers or distributors.<sup>35</sup> This can be illustrated in compliance with Article 74 of the Contract Law 1999, in which “free transfer” and “transfer at a price that is obviously unreasonable” are excluded.<sup>36</sup> This construction can be justified when “normal business operations” is read in line with the “reasonable price” and “obtain the property”. However, this does not mean that the chargee can intervene in the disposal right of the chargor. The limitation actually is imposed on the scope and the means of transactions. Despite of these limitations, if the chargor deals with assets within these restrictions, the chargee does not have the substantial control over the commercial value of the assets. From the perspective of the third-party, Article 189(2) means that the buyer in the normal business operation cannot be traced.<sup>37</sup> It was also submitted that there was no need to distinguish the buyer between good faith and bad faith.<sup>38</sup> Even if the buyer has the knowledge of the floating charge on the trading object, the legal acquisition of the charged property is not affected by the security interest, as long as the chargee’s secured interest is not affected.<sup>39</sup> Provided with these analyses, Article 189(2) does not restrict substantially on the right of the chargor to deal with charged assets. The provisions in the Property Law 2007 create at least an analogous floating charge.

However, the extent of the control reflected from the credit operation of the bank in practice is totally the opposite. It is found that when creating a floating charge, a standard floating charge debenture from the bank provides circulating credit with a specific maximum credit line.<sup>40</sup> The objects of the charge are same as those provided in Article 186, and the assets earned later will be automatically added into the charge. The chargor possesses charged assets and can deal with them without the chargee’s approval. However, before granting the loan, there will usually be an insurance requirement. The chargor needs to obtain insurance policy with regard to the charged assets and assign it to the bank as beneficiary.<sup>41</sup> Furthermore, upon the creation of the floating charge, the bank

---

<sup>34</sup> Liming Wang, *Research on Property Law* (Renmin University of China Press 2012) 1284.

<sup>35</sup> Huixing Liang, ‘Collective Mortgage of Special Movable Property’ (Chinese Academy of Social Science 2007) <http://www.iolaw.org.cn/showArticle.aspx?id=2182> accessed 23 February 2018.

<sup>36</sup> 1999 Contract Law, art 74.

<sup>37</sup> Xueli Dong, ‘Property Changes and Validity Restrictions on Floating Charge’ (2010) 1 Chinese Journal of Law 63, 70.

<sup>38</sup> Wenjie Liu, ‘Study on Dormancy Rule of Floating Charge’ (2014) 29 Graduate Law Review 34, 41.

<sup>39</sup> Ping Jiang, *Property Law of the People’s Republic of China: Explained* (China University of Political Science and Law Press 2007) 245.

<sup>40</sup> Williams and Lu (n 2) 39.

<sup>41</sup> *ibid* 40.

will “conduct field investigations, design an operational plan, and designate a custody warehouse”, often from one of the bank’s designated warehouses.<sup>42</sup> This practically suggests that most chargors will no longer take possession of charged assets in their business operation. Actually, when the security device is executed, the bank will require the chargor to transfer physical assets to the custody of a specific warehouse. The custodian holds them for the bank. This indicates, at least, the great desire of the bank to exercise physical control over charged assets. The custody agreement includes a provision of “threshold of minimum value”, which means that the chargor has to set aside a part of assets under the control of the chargee.<sup>43</sup> Under that requirement, the chargor can only deal with the rest part of the charged assets freely without the consent of the chargee. This custody arrangement, together with the value requirement, strongly suggests that the bank is reluctant to create a floating charge for the company. Even if the bank accepts a floating charge, the chargor does not have the absolute and substantive freedom to deal with charged assets in the ordinary course of business.<sup>44</sup> This does negate the distinguishable characteristic of the floating charge and conform a little with the fixed charge.

## 5. Evaluation of the Floating Charge in China

There are two main concerns in modern commercial transactions, namely efficiency and safety.<sup>45</sup> The right of charge is substantially the right of value, which means the utilisation over the commercial value of assets.<sup>46</sup> Compared with other security rights requiring transfer of possession or title of assets, the commercial value matters more in the right of charge. The nature of the charge determines that the object of the charge interest is not the physical property, but the exchange value of the property.<sup>47</sup> In this sense, the floating charge in China maximises the commercial value of assets. It enables chargors to make use of the property freely for their commercial purposes. This, in turn, increases the chargor’s ability to pay off the loans. However, efficiency and safety conflicts more fiercely in this context. As the main parties of the floating charge system, chargors pursue efficient and economic benefits, while chargees intend to secure their credits and minimise their exposure to non-repayment risks. Therefore, the main problem faced with Chinese floating charge is to resolve such conflict. Ideally, the floating charge system should properly coordinate the interests of the parties, while the reality is not always as expected. That requires not only the function of the floating charge legislation, but also the efficient operating scheme to realise these functions. The discrepancy between the theory and practice in China may be explained by the imperfect legal framework in Chinese security law.

The floating charge is essentially a security device. It is created to provide guarantee for the pay-off of the credit. Safety should be the fundamental value and the ultimate goal of the floating charge system, otherwise creditors would be unwilling to make transactions as such.<sup>48</sup> In this sense, when the value of safety and efficiency conflicts, the secured interest of creditors should be the first choice. Given Article 189(1) of the Property Law 2007, a floating charge shall be established at the time when the mortgage contract enters into force. Failure to register does not render the charge itself void. It just prevents the chargee from claiming priority against a bona fide third party in case of a dispute over the secured property.<sup>49</sup> Clearly, the Property Law 2007 incorporates registration antagonism on the issue of registration and validity. The chargee’s interest is protected in this way as against the third party. Article 189(2) subsequently stipulates the chargor’s right to dispose of the charged property, which is not affected by the registration of the charge. This is exactly the essence of the floating charge system. This provision actually involves the chargor, the chargee and the third

---

<sup>42</sup> *ibid* 41.

<sup>43</sup> *ibid* 41.

<sup>44</sup> *ibid* 41.

<sup>45</sup> Xinyan Ma and Guannan Lu, ‘The Value Conflicts and Settlement of Floating Charge System’ (2015) 11 *Shandong Social Science* 66, 67.

<sup>46</sup> *ibid*.

<sup>47</sup> Ying Zhang, ‘The Value Orientation of Floating Charge and Its Transplant’ (2006) 5 *Economic Research Guide* 23, 25.

<sup>48</sup> *ibid*.

<sup>49</sup> 2007 Property Law, art 189(1).

party. On the one hand, by restricting the chargee to exercise the right of charge, the legitimate rights of the chargor and the third party can be protected. The chargor can continue its ordinary course of business with the third party, which is the real concern of the chargor when they create the floating charge. The third party, accordingly, hope to ensure the safety of the transaction. On the other hand, the chargee sets out restrictions to the chargor in order to protect the realisation of the secured interest. This provision actually is the allocation of risks and the arrangement of different concerns. The legislators were seeking to make a balance among different parties' particular interests. However, this provision is not clear enough that leads to practical problems. There is currently no statutory interpretation to explain the controversial issues in practice. "Normal business operations" and "reasonable price" is still hard to define. If a wide approach is adopted that does not impose necessary and reasonable restrictions on the trading power of the chargor, the chargor is very likely to abuse this right. This will put the chargee in a highly disadvantageous position. However, if the provision is interpreted so narrowly, the advantage of the floating charge will be undermined. Actually, the interpretation of the chargor's right is a question of value judgment. The scope of defining reflects the attitude and arrangement of legislators to the interests of different parties.<sup>50</sup> Except for this, the Property Law 2007 did not provide other special relief methods to prevent and monitor the chargor from malicious misuse of the charged property. Although the chargee may, in accordance with Article 196 (4), crystallise the property when "other circumstances that seriously affect the realisation of claims" occur, such "serious impact" is ambiguous too.<sup>51</sup> When the "impact" has been "serious" enough to achieve the degree of crystallisation, the charged property may not be much left. How to secure the interest of the chargee in this circumstance is another problem.

In English law, there are comprehensive regulations to facilitate the operation of the floating charge and reduce the financial risk of chargees. For example, the key issue on the enforcement of the floating charge is to ensure that chargees can effectively take control over the charged property when debtor companies meet financial difficulties or enter into bankruptcy. Common law and equity have addressed this issue in the creation of "receivership".<sup>52</sup> The power to appoint a professional receiver serves as an effective remedy available to chargees. The receiver can be assigned by the creditor or be appointed by the court order. The receiver enjoys extensive rights for the purpose of maximising the interests of the enterprise. On the one hand, the receiver is eligible to run the company and manage the property of the enterprise. He can even participate in the litigation in the name of the enterprise. On the other hand, the receiver also has certain obligations, such as due diligence and acting in good faith. Failing to do so will lead to the liability for damage.<sup>53</sup> Although the receivership deprives the chargor of the right to manage the property, it does not fundamentally deny the essence of the floating charge. The charged property is still "floating", and the chargor company could still continue its business transactions for maximum profits, provided that the actual manager is no longer the chargor, but the receiver. Receivership in this way promotes efficient utilisation of the property and minimises the risk accompanied with management misconduct. The law on receivership thus constitutes a very powerful remedy for secured creditors.<sup>54</sup> In contrast, however, there is no corresponding regulation in Chinese insolvency law system. Under the Property Law 2007, secured creditors only have two means to enforce their security, namely negotiating with the chargor or applying for judicial enforcement.<sup>55</sup> In reality, this is the weakness of Chinese remedy system. Negotiations often prove futile due to the debtor's indebtedness.<sup>56</sup> Even if the dispute is brought to court, there is likely to be a long waiting before the judicial enforcement. During this period, the chargor continues to run the charged company. When the court order is issued, very often there is little value left. Perhaps chargees can resort to the "property preservation" procedure under the Civil Procedure

---

<sup>50</sup> Baomin Wang, 'On Core Values and Practical Issues of the Floating Charge System' (2009) 5 *Western Law Review* 70, 72.

<sup>51</sup> 2007 Property Law, art 196(4).

<sup>52</sup> Gavin Lightman and others, *The Law of Administrators and Receivers of Companies* (6<sup>th</sup> edn, Sweet & Maxwell 2017) ch 1.

<sup>53</sup> Insolvency Act 1986, pt 3 ch 1.

<sup>54</sup> Williams and Lu (n 2) 54.

<sup>55</sup> 2007 Property Law, art 195.

<sup>56</sup> Williams and Lu (n 2) 55.



Law 1991, or apply for prohibition pursuant to the Contract Law 1999.<sup>57</sup> Again, these timely and financially consuming remedies provide little help to creditors. In Chinese economic market where fraud is still a severe issue in business transactions, this may explain banks' reluctance in trusting their customers.

## 6. Conclusion

The floating charge has been comprehensively developed over the years since 1870s. Especially after several recent cases, the floating charge distinguishes more clearly with the fixed charge. The court in England concentrates on the chargor's actual ability to deal with secured assets. In light of *Re Spectrum Plus*, the pivotal distinction between the fixed and floating charge is related to the issue of the freedom of debtors to deal with charged assets and the level of the control by creditors over the same.<sup>58</sup>

The importation of the floating charge is a breakthrough in Chinese legal regime. Chinese security law has historically developed with more emphasis on the safety of the secured interest.<sup>59</sup> This results in the mortgage-backed security market in China.<sup>60</sup> While modern commodity economy and financing market require rapid capital flow. The value of efficiency expressed by the imported floating charge is unprecedented. In this sense, the floating charge in the Property Law 2007 embodies this vital characteristic. However, the most important reason for the floating charge to exist as a security device is to coordinate security and efficiency. The floating charge legislation needs to strike a delicate balance between reducing financial risk of creditors and promoting asset utilisation of debtors. However, because of the improper arrangement, the floating charge exists inharmoniously with other provisions in the Chinese statute. Also, due to the absence of ancillary regulations, the privately-owned small and medium enterprises cannot practically take advantage of the floating charge. The initial expectations for the floating charge are still far from being materialised.

As is widely recognised, the security regime is a reflection of the legal, historical, political and even cultural environment of the country.<sup>61</sup> English law, with the contribution of equity and case law, has developed a comprehensive system for the floating charge in the past centuries. In case law system, judges constantly create and interpret the law to make it suitable for social changes and developments. This promotes the realisation of fairness and justice. Chinese legislators are still faced with the challenge of rectifying this newly imported, but malfunctioning security legislation. The first step will probably be clarifying the confusion and correcting the misunderstanding in the transplanting process. Then, adding ancillary rules to make the concept function in the Chinese setting. China is still in the process of overhauling its civil law system and aspires to enact a comprehensive Civil Law Code. The security right over property is a key issue in the new Property Law 2007 that will eventually form part of the completed Civil Law Code. The most important but challenging work is to turn the seemingly incompatible parts into an internally coherent and consistent legal system. If it becomes true, the quality of Chinese legislation will accomplish a massive leap.

**Lei Zhang**

*(The author is a postgraduate student at University College London)*

<sup>57</sup> 1991 Civil Procedure Law, art 92; 1999 Contract Law, art 74.

<sup>58</sup> Addy (n 17) 17.

<sup>59</sup> Xiaogeng Zhao (ed), *Identity and Contract: Chinese Traditional Civil Law Form* (Renmin University of China Press 2012) 559-62.

<sup>60</sup> Mark Hsiao, 'The Legal Transplant of the English Floating Charge and the Pledge over Receivables into Chinese Law' (2014) 2 JBL 141, 141.

<sup>61</sup> Nathalie Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation' (2005) 28 BC Int'l & Comp L Rev 1, 5.