

Charges and their effectiveness against Liquidators

► By Shane Grant, Partner
Rudkin Hitchcock

Charges are an effective tool to make specific property answerable for payment of a debt by a company. The creation and types of charges are far too broad a topic to be covered here, but what is particularly topical at the moment is their effectiveness against Liquidators or Administrators once a company is placed into liquidation or administration.

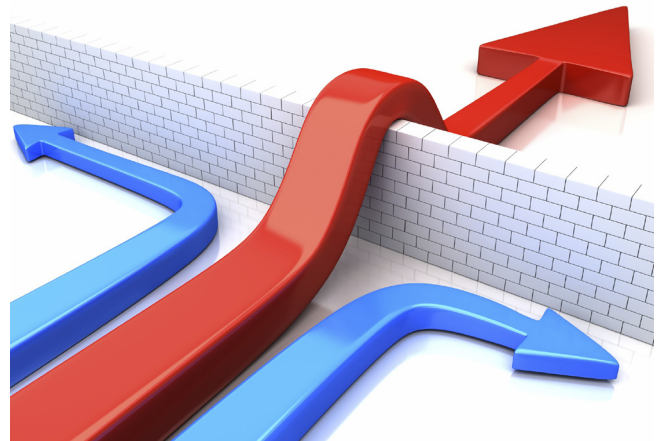
The focus of this article is the various powers enabling insolvency practitioners to attack the enforceability of charges.

Registration

In scrutinising charges, one of the first considerations of a Liquidator or Administrator is whether the Charge has been registered with ASIC.

Section 266 of the Corps Act provides that a registrable charge is void as a security against a liquidator or administrator unless it is lodged for registration with ASIC within either:

- i) The relevant period (normally 45 days from creation of the Charge); or



- ii) 6 months of being wound up or placed into administration.

This same rule holds true where the charge is varied, for instance to increase the amount to be secured.

It is important to remember that in this context, the failure to register a Charge (or a variation to a charge) does not invalidate that charge but rather it leaves it open to attack by a liquidator or administrator.

Whilst this may seem like a standard administrative task by a Charge holder, experience shows that registration of Charges or subsequent variations can often be delayed for administrative reasons thereby affecting their enforceability against a Liquidator. **Continued on page 4**

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Property Law Act Fraud Decision: Regal Castings Limited

► By Tony Johnson, Partner & Philip Shackleton, Associate
Martelli McKegg Wells & Cormack

The issue was whether the transfer of the home to the family trust was an alienation of property with intent to defraud creditors pursuant to the Property Law Act 1952.

The Supreme Court unanimously determined that there was a fraud under the Act. In doing so, the Court overturned the earlier decision of the Court of Appeal.

The relevant facts were:

- November 1998 the home was transferred by L to a Trust;
- The consideration for the transfer was a debt back to L of \$230,000 (to be repaid in one sum in November 2005);
- Gifting by L commenced in November 1998 and continued progressively until the debt was extinguished in December 2002.
- At the time of the transfer, L had personally guaranteed debts owed by his business (Capro) to Regal Castings. The details of the debt being:
 - A long outstanding debt had been restructured in 1995 into a term loan of \$356,000 (interest had been waived) with monthly instalments to be paid and with the balance owed to be paid in 2000.
 - By November 1998 the term loan had been reduced to \$220,000 but the monthly instalment payments had risen to \$4,000 per month.
 - Regal Casting had continued to supply Capro on normal terms and its current account debt stood at some \$90,000 (\$65,000 of which was in arrears);
 - Despite the arrears, no demand had been made upon L as guarantor.
- Regal Casting was not told of the transfer of the home or of the gifting programme;
- Capro was placed into liquidation in April 2003. At that time Regal Casting was owed \$15,000 on the term loan and \$149,000 for further supplies.
- L was subsequently bankrupted.

The dissenting judgment in the Court of Appeal came from Justice William Young. His view was that it was perfectly clear the debt was in the mind of L at the time of the transfer. He indicated knowledge of consequence could be equated with intent. He indicated Capro was insolvent at the time of the

alienation, there was a clear intention to gift all the debt and the fact that it took time to do so was irrelevant. He also confirmed his view that L acted dishonestly when he made away with assets during the period of an extension of time granted to him and his company.

The Supreme Court Justices to varying degrees, supported Justice William Young's judgment.

All Justices accepted that "intent to defraud" included intending to hinder, delay or defeat a creditor in exercising any right of recourse of the creditor in respect of property of the debtor. This is how the concept is now expressed in section 345(1)(a) of the Property Law Act 2007.

The lessons to take from the decision are that fraud under the Act is much wider than might be anticipated, the state of a disposers financial position is crucial in determining the legitimacy of the disposition and a consistent program of gifting does not of itself protect a disposition from challenge.

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How much knowledge is required for knowing receipt? The first limb of Barnes v Addy amidst corporate failures

► By James Graham, Lawyer, Madgwicks

Lenders and clients engaging in transactions that may affect multiple parties should be aware of the possibility of claims for as a constructive trustee for knowingly receiving trust property tainted by another party's impropriety. This risk is more acute amidst corporate failure, as it is lenders and other solvent parties against whom relief will likely be sought.

Long established as the "first limb" of Barnes v Addy (1874) LR 9 Ch (Barnes), a party may be considered to be a constructive trustee (and liable in knowing receipt to others that have lost the benefit of trust property) if it receives trust property in the knowledge that it related to some misapplication of the trust property or a breach of fiduciary duty. A "second limb" of Barnes deals with liability where a party knowingly assists in a dishonest or fraudulent breach of duty by a trustee.

In practice, courts' handling of knowing receipt has been criticised for being overly concerned with the question of the party's knowledge rather than with the gravity of the party's action itself. The High Court in Farah Constructions Pty Ltd v Say-Dee Pty Limited [2007] HCA 22 (Farah) recently reiterated that notice and knowledge are essential in knowing receipt, but did not finally settle the question under the first limb of what will constitute knowledge for contracting parties.

More recently, in the Federal Court case of Imobilari Pty Ltd v Opes Prime Stockbroking Ltd (in liq) (recs mgrs appt) and ors 252 ALR 41 (Imobilari), Finkelstein J gave a clearer account of what knowledge will give rise to a claim for the purpose of establishing knowing receipt in Australia.

The Imobilari case arose from the collapse of Opes Prime Stockbroking, dealing with financiers' liability for alleged misconduct by the failed company. Among other things, the plaintiff claimed that the defendant banks were liable for knowing receipt under the first limb of Barnes and also under statutory schemes, which prohibit being a knowing party to any contravention by direct or indirect act or omission under s.79 of the Corporations Act 2001 (Cth) and s.75B of the Trade Practices Act 1974 (Cth).

"that would put an honest and reasonable person on notice (but not merely inquiry) of a real and not remote risk that the transfer was in breach of trust or fiduciary duty or involved the misapplication of trust property".

Finkelstein J noted that only actual knowledge will establish secondary liability under the two statutory provisions. What knowledge is therefore needed for a Barnes knowing receipt claim?

Finkelstein J suggests that after Farah, as a minimum, it is sufficient to prove knowledge of facts "that would put an honest and reasonable person on notice (but not merely inquiry) of a real and not remote risk that the transfer was in breach of trust or fiduciary duty or involved the misapplication of trust property". Finkelstein J also suggested that an even simpler test of knowledge should apply to both limbs of Barnes, by which a defendant would be deemed to have knowledge if they at least acted recklessly in receiving trust property that was misapplied or transferred in breach of trust or of fiduciary duty.

It is disturbing to note that the Imobilari decision was handed down within weeks of the recent judgment handed down in The Bell Group Ltd (in liq) case, number 9 by Owen J in the Supreme Court of Western Australia, another Barnes case against banks which heralds from Australia's last recession in 1990. Whichever way the question of knowledge is determined by the Courts, clients are well-advised to beware of their involvement in transactions where knowledge of impropriety could be inferred.

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Other Avenues of Challenge

Whilst registration of Charges provides significant protection for Charge holders, there are still other considerations which enable a Liquidator to challenge a Charge as a voidable transaction, including:

1. Unfair Preference (s588FA)

A Charge may be voidable by a Liquidator where it is given in favour of a creditor within the relevant period (normally 6 months from when from when the winding up application is filed) and it can be shown that:

- (a) Entering the Charge provides a preference/advantage to the charge holder over other unsecured creditors; and
- (b) The company was insolvent at the time of creating the charge or became insolvent as a result;

2. Uncommercial Transaction (s588FB)

A Charge will be an uncommercial transaction and therefore voidable by a Liquidator if it can be shown that it was not reasonable for the company to create the charge having regard to the benefits provided to the company and its obligations. In other words, a reasonable person in the position of the company would not have given the Charge having regard to the company's position and the benefits that it would derive from it.

3. Floating Charges (s588FJ)

A floating Charge created by a company within 6 months of the 'relation back day' will be void as against the Liquidator unless it can be shown that fresh consideration was given to support the Charge or it can be shown that the Company was solvent at the time immediately after the time the Charge was created.

4. Charges in Favour Relevant Persons (s267)

Where a charge is created by a company in favour of a director or other relevant person and that person takes a step to enforce that Charge without the leave of the Court (eg appoint a receiver) within 6 months of its creation, then that Charge is void.

Given the many potential points of challenge by a Liquidator, it is important that practitioners consider the implications of all of the above issues upon the creation of the charge, to best ensure that they are enforceable in the immediate future should the chargor company become insolvent.

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SWAAB

New South Wales
Level 1
20 Hunter Street
Sydney NSW 2000
Fred Swaab
T: +61 2 9233 5544

www.swaab.com.au


MacDonnells Law
BRISBANE | CAIRNS | TOWNSVILLE

Queensland
Level 14 BOQ Centre
259 Queen Street
Brisbane QLD 4000
GPO Box 79 Brisbane QLD 4001
Russell Beer
T: +61 7 3031 9700

www.macdonnells.com.au

Cnr Shields and Grafton Streets
Cairns QLD 4870
PO Box 5046 Cairns QLD 4870
Russell Beer
T: +61 7 4030 0600

Level One
131 Denham Street
Townsville QLD 4810
PO Box 1015
Townsville QLD 4810
Russell Beer
T: +61 7 4722 0220

RUDKIN HITCHCOCK
LAWYERS

35-39 Scarborough Street
Southport, QLD 4215
Robbie Rudkin | David Tierney
T: +61 7 5532 2021

www.rudkinhitchcock.com.au

MADGWICKS
Lawyers

Victoria
Level 33, 1450 William Street
Melbourne, VIC 3000
Peter Kennedy | Graeme Levy
T: +61 3 9242 4744

www.madgwicks.com.au

DowningsLEGAL

Western Australia
Level 11, 2 Mills Street
Perth, WA 6000
Mitch Artus | Veronica Jumeaux
T: +61 8 9321 1211

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MARTELLI M'KEGG
WELLS & CORMACK
Lawyers

Auckland - New Zealand
Level 20
PricewaterhouseCoopers Tower
188 Quay Street
Auckland 1010, New Zealand
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