



# fact sheet

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## Security interests and corporate insolvencies

This fact sheet gives a general overview of external administration and how it interacts with the *Personal Property Securities Act 2009* (Cth) (the PPS Act). It builds on the information presented in Fact sheet 20: *The Personal Property Securities Act*<sup>4</sup> and provides further details about the PPS Act and the *Corporations Act 2001* (Cth) – in particular, Ch 5 of the Corporations Act.<sup>5</sup>

This fact sheet examines specifically the situation where the Commonwealth has taken a security interest and looks at the impact of Ch 5 (external administrations) on that security interest.

As a general rule, the appointment of an external administrator may:

- impact on the enforcement of a **perfected** security interest
- cause the loss of an **unperfected** security interest.

### Corporations Act – an overview of external administration

Chapter 5 of the Corporations Act provides for the external administration of companies. In the majority of cases, a company comes under external administration because it is in financial distress or insolvent.

There are 4 main forms of external administration:

- **Receivership** ordinarily arises where a secured creditor, under the terms of a security agreement, appoints a receiver to the property of the corporation to take control of and realise the secured property for the benefit of secured creditor.<sup>6</sup>
- **Voluntary administration** involves the appointment of an independent registered liquidator (called an administrator) to the company,<sup>7</sup> usually by the directors.<sup>8</sup> The administrator is appointed for a discrete period to take control of the company;<sup>9</sup> investigate the company's affairs;<sup>10</sup> and convene a meeting of the company's creditors to decide the company's future – in particular, whether it will execute a deed of company arrangement (see below).<sup>11</sup> Voluntary administration aims to maximise

### Glossary

**Collateral:** generally, the personal property to which a security interest is attached.<sup>1</sup>

**Perfected/unperfected security interest:** the *Personal Property Securities Act 2009* (Cth) sets out a number of ways in which a security interest can be perfected, including by possession or by registration on the Personal Property Securities Register (PPS Register).

**Security agreement:** generally, an agreement that creates or provides for a security interest.<sup>2</sup>

**Security interest:** an interest in personal property that the owner of personal property, or a person with rights in the personal property, gives to a secured party – for example, a creditor – to secure payment or the performance of an obligation.<sup>3</sup>

1 *Personal Property Securities Act 2009* (Cth) (PPS Act), s 10.

2 PPS Act, s 10.

3 PPS Act, s 12.

4 See [www.ags.gov.au/publications/fact-sheets](http://www.ags.gov.au/publications/fact-sheets)

5 This fact sheet provides a high-level, generalised discussion of the implications of the external administration provisions of the *Corporations Act 2001* (Cth) (the Corporations Act). It does not consider all possible implications for all types of security interests.

6 Receivers and other controllers are regulated by Corporations Act, Pt 5.2. For the purposes of this fact sheet, we assume that the receiver is a receiver and manager appointed over all the assets and undertakings of a company. In some circumstances, however, a receiver's appointment may be more discrete – relating to specific assets.

7 Corporations Act, ss 448B, 448C; *Bovis Lend Lease Pty Ltd v Wily* (2003) 45 ACSR 612 at 641 [123].

8 See Corporations Act, ss 436A, 436B and 436C.

9 Corporations Act, Pt 5.3A, Div 3. This is to the exclusion of the company's officers: see Corporations Act, s 437C.

10 Corporations Act, Pt 5.3A, Div 4.

11 Corporations Act, Pt 5.3A, Div 5.

the chances that the company, or as much of its business as possible, can continue to exist. Even if that is not possible, voluntary administration aims to result in a better return for the company's creditors and members than if the company was immediately wound up.<sup>12</sup>

- **Deeds of company arrangement** are formal work-out documents that bind creditors.<sup>13</sup> They provide the extent to which the company is released from debts or is allowed a moratorium on recovery of debts. A deed of company arrangement is created if the creditors of a company under voluntary administration resolve that the company will execute a deed.<sup>14</sup>
- **Liquidation** is the process whereby a liquidator is appointed to, ordinarily, an insolvent company to wind-up the company's business, conduct an investigation of its affairs and distribute proceeds from the realisation of the company's assets to creditors. Liquidation can be initiated either by the company or by court order (ordinarily on the application of a creditor).<sup>15</sup>

Many contracts will provide that any form of external administration triggers a right for the other party to terminate the contract or, in the case of a security agreement, enforce the security interest.

### How does external administration affect security interests over personal property?

#### Appointment of a receiver:

- may provide grounds for the Commonwealth to enforce its security interest but limits the Commonwealth's enforcement options:<sup>16</sup>
  - under the general law, the appointment of a receiver does not have the effect of discharging or terminating a contract<sup>17</sup>
  - the Commonwealth will be prevented from having recourse to the enforcement provisions of the PPS Act<sup>18</sup> but will still be able to enforce its rights under its security agreement and the general law where it has a higher-ranking security interest
- will not defeat the Commonwealth's security interest but may, as a practical matter, result in the Commonwealth losing an unperfected security interest:
  - a receiver will take possession of the company's property subject to all security interests
  - as such, the appointment of a receiver will not defeat the Commonwealth's security interest. It is unlikely that the appointment of a receiver will improve the secured creditor's priority as against other unperfected security interests.<sup>19</sup>
  - a receiver is ordinarily appointed to take possession and sell the company's property. As such, receivership is likely to show the benefit of having a perfected security interest.
  - if the Commonwealth has not perfected its security interest (for example, by registration on the PPS Register) and the receiver sells the collateral, the purchaser is likely to take the personal property free of the Commonwealth's security interest<sup>20</sup>

12 Corporations Act, s 435A.

13 Corporations Act, s 444A(4).

14 Corporations Act, s 444A.

15 See generally Corporations Act, Pts 5.4, 5.4A and 5.5.

16 PPS Act, s 116(1).

17 *Re Diesels and Components Pty Ltd (receivers and managers appointed)* (1985) 2 Qd R 456 at 458 per McPherson J; *George Barker (Transport) Ltd v Eynan* [1974] 1 WLR 462; *Parsons v Sovereign Bank of Canada* [1913] AC 160.

18 PPS Act, s 116(1).

19 Possession is a means of perfection. Section 55(3) of the PPS Act provides that, as a general rule, a perfected security interest has priority over an unperfected security interest. However, s 21(2)(b) of the PPS Act provides that perfection does not occur where possession is as a result of the 'seizure' or 'repossession' of the collateral. Further, ss 123 and 123(4) of the PPS Act, when read together, provide that a secured party seizing the collateral 'by any method permitted by law' does not perfect the secured party's security interest in the collateral. The terms 'seizure' and 'repossession' may be wide enough to capture the appointment of a receiver to take possession of the collateral. As a matter of practice, however, the issues may rarely arise. While, under the general law, a receiver enters into possession as agent of the secured party (taking possession of the collateral on behalf of the secured party), the security agreement will invariably provide for the receiver to be appointed as the agent of the company, taking possession on behalf of the company – preventing perfection by possession by the secured party: PPS Act, s 24; *Vimbos Ltd* [1900] 1 Ch 470 at 473; *Peat Marwick Ltd v Consumers' Gas Co* (1980) 113 DLR (3d) 754 at 755–756. See discussion of history of receivership in *Carey v Korda (as receiver and manager of Huntingdale Village Pty Ltd)* (2012) 91 ACSR 572 at 580[45]–583[58] per Murphy JA (Martin CJ and Newnes JA agreeing).

20 PPS Act, s 43(1). There is a narrow exception – where the buyer was a party to the transaction creating the security interest (subject to the regulations): see PPS Act, s 43(2).

- the Commonwealth’s security interest may ‘attach’<sup>21</sup> to the proceeds<sup>22</sup> but, unless the receiver is on notice of the Commonwealth’s interest, the proceeds may be dissipated and limit the Commonwealth’s recovery options to a claim in tort against the receiver<sup>23</sup>
- may result in the collateral the subject of a perfected security interest being sold free of the Commonwealth’s interest. However, the Commonwealth’s interest should still be protected:
  - a receiver may apply under s 420B of the Corporations Act for court orders authorising the sale of the collateral, despite the Commonwealth’s prior security interest. The order may be made subject to conditions, including that part of the sale proceeds be paid to the Commonwealth.<sup>24</sup>

**Other external administration**

The appointment of external administrators (other than receivers) may:

- cause the Commonwealth to lose its security interest because that interest is either unperfected or registered too late
- limit the enforcement options for perfected security interests.

**Unperfected security interests**

**If:**

- a **winding-up** order is made or resolution passed or<sup>25</sup>
- an **administrator** is appointed or
- a **deed of company arrangement** is executed

**+**

the security interest is unperfected at that time

**=**

the security interest is lost and vests in the grantor.<sup>26</sup>

**Security interests registered too late**

If a security interest is only perfected by registration

**+**

- it is not registered at least 6 months before the external administration started **and**
- within 20 business days after the security agreement that gave rise to the security interest came into force **or**
- within such further time as allowed by a court order<sup>27</sup>

**=**

it will generally vest in the grantor unless it was registered.<sup>28</sup>

21 The term ‘attachment’ is used to describe the successful creation of a security interest in personal property. A security interest is only effective if it has attached to the personal property. At this point a proprietary right is created allowing an effective and enforceable security interest in the personal property against the grantor of the interest. The onus of proving attachment lies with the person claiming that the security interest has attached to the personal property.

22 PPS Act, s 32(1)(b).

23 Where a receiver deals with property beyond their authority, they may be held liable in conversion: see *Barrymores Pty Ltd v Harris Scarfe Ltd* (2001) 162 FLR 258 at 276–277 [94] per Roberts-Smith J.

24 There are other means by which a receiver can sell the collateral free from a perfected security interest – for example, where the collateral is sold in the ordinary course of the company’s business of selling property of that kind. However, the Commonwealth’s security interest will attach to the proceeds of the sale: PPS Act, ss 32 and 46. Where the receiver sells the collateral, the receiver may be entitled to take their costs from the sale proceeds in priority to the Commonwealth’s prior security interest: *Dean-Willcocks v Nothintoohard Pty Ltd (In Liquidation)* (2007) 13 BPR 24, 245; (2007) 25 ACLC 109; [2006] NSWCA 311. This also may be provided for or effected by the orders made by the Court under s 420B of the Corporations Act. Also, certain debts (such as employee entitlements) will be paid in priority to debts owed by a circulating security interest (what was formerly known as a floating charge): Corporations Act, s 433.

25 In some circumstances the winding-up of a company will void, as against a company’s liquidator, circulating security interests created in the 6 months before the commencement of the winding-up, except so far as it secures new advances and liabilities: Corporations Act, s 588FF.

26 PPS Act, s 267. This includes where the security interest attaches after the critical date: PPS Act, s 267A. Note that various security interests are unaffected by s 267: PPS Act, s 268.

27 A court may extend the time for registering the security interest where the court is satisfied that the failure to register was either accidental or due to inadvertence or some other sufficient cause; or is not of such a nature as to prejudice the position of creditors or shareholders; or, on other grounds, it is just and equitable to grant relief. Section 588FM of the Corporations Act is, in material respects, in the same terms as the now repealed s 266(4) of the Corporations Act. Under s 266(4), the application to extend time could be made after the critical time (that is, after the external administration commences): *Hewlett Packard Australia Pty Ltd v GE Capital Finance Pty Ltd* (2003) 203 ALR 51; see also *Re Cardinia Nominees Pty Ltd* [2013] NSWSC 32; *Re Barclays Bank PLC* [2012] NSWSC 1095.

28 Corporations Act, s 588FL(4).

***Perfected security interests that are not registered too late***

Assuming that your security agreement gives you the right to enforce on the appointment of an external administrator then:

Appointment of a voluntary administrator	=	security interests may only be enforced in limited circumstances, <sup>29</sup> generally where: <ul style="list-style-type: none"> <li>— the security interest is over the whole, or substantially the whole, of the property of the company</li> <li>— enforcement action commences: <ul style="list-style-type: none"> <li>– before the commencement of the administration or</li> <li>– within 13 business days after the administration begins.<sup>30</sup></li> </ul> </li> </ul>
Deed of company arrangement	=	Security interests may be enforced, except where the secured creditor voted in favour of the deed and the deed prevents the secured creditor from taking enforcement action. <sup>31</sup>
Appointment of a liquidator (winding-up)	=	The liquidation of a company has a limited impact on perfected security interests. <sup>32</sup> It does not affect a secured party's right to enforce a security interest. <sup>33</sup>

**Conclusion**

One of the primary reasons for the Commonwealth taking security is to protect its interests in the event of the external administration of a corporate debtor.

However, a security interest may afford no or limited protection unless that interest is perfected.

Registration of a security interest on the PPS Register is a simple and effective means of perfecting a security interest.

<sup>29</sup> Corporations Act, ss 440B, 440D and 440F. However, the secured party is not prevented from giving the company a notice under the security agreement: see Corporations Act, s 441E.

<sup>30</sup> Or otherwise 13 business days from the date on which notice is given under s 450A of the Corporations Act to the secured party.

<sup>31</sup> Corporations Act, s 444D. The court may also, in some circumstance, order that a secured creditor not realise or otherwise deal with its security interest: see Corporations Act, s 444F.

<sup>32</sup> If the secured party has appointed a receiver as agent of the company, the relationship of agency will terminate on the appointment of the liquidator: see the summary of authorities in *St George Bank Ltd v JB (Northbridge) Pty Ltd* (2009) 262 ALR 538 at 544[18]–547[24] per Brereton J.

<sup>33</sup> Corporations Act, s 471C. This includes the appointment of a receiver. A security interest may be lost if the secured creditor proves for the secured debt.

**More information**

If you require further information or advice on security interests and corporate insolvencies, and what AGS can do to help, please contact:

**Canberra**

<b>Chris Behrens</b> <i>Senior Executive Lawyer</i>	02 6253 7543
christopher.behrens@ags.gov.au	
<b>Helen Curtis</b> <i>Senior Executive Lawyer</i>	02 6253 7036
helen.curtis@ags.gov.au	
<b>Zita Rowling</b> <i>Senior Executive Lawyer</i>	02 6253 7426
zita.rowling@ags.gov.au	
<b>Jim Sullivan</b> <i>Senior Executive Lawyer</i>	02 6253 7578
jim.sullivan@ags.gov.au	
<b>David Lewis</b> <i>Senior General Counsel</i>	02 6253 7541
david.lewis@ags.gov.au	
<b>Mark Molloy</b> <i>Senior General Counsel</i>	02 6253 7421
mark.molloy@ags.gov.au	
<b>Sacha Moran</b> <i>Senior General Counsel</i>	02 6263 3972
sacha.moran@ags.gov.au	
<b>Leah Lyons</b> <i>Senior Lawyer</i>	02 6253 7468
leah.lyons@ags.gov.au	
<b>Nigel Oram</b> <i>Senior Lawyer</i>	02 6253 7239
nigel.oram@ags.gov.au	
<b>Phil Sedgley-Perryman</b> <i>Lawyer</i>	02 6253 7356
phil.sedgley-perryman@ags.gov.au	

**Sydney**

<b>Simon Konecny</b>	02 9581 7585
<i>Deputy General Counsel Commercial</i>	
simon.konecny@ags.gov.au	
<b>David Morris</b> <i>Senior Executive Lawyer</i>	02 9581 7622
david.morris@ags.gov.au	
<b>Matthew Walsh</b> <i>Senior Executive Lawyer</i>	02 9581 7517
matthew.walsh@ags.gov.au	
<b>Michael Brann</b> <i>Senior Lawyer</i>	02 9581 7431
michael.brann@ags.gov.au	
<b>Kate Cabot</b> <i>Senior Lawyer</i>	02 9581 7313
kate.cabot@ags.gov.au	
<b>Emma Whan</b> <i>Senior Lawyer</i>	02 9581 7581
emma.whan@ags.gov.au	

**Melbourne**

<b>Teresa Miraglia</b> <i>Senior Executive Lawyer</i>	03 9242 1493
teresa.miraglia@ags.gov.au	
<b>Vince Tavoraro</b> <i>Senior Executive Lawyer</i>	03 9242 1359
vince.tavoraro@ags.gov.au	
<b>Robyn Curnow</b> <i>Senior Lawyer</i>	03 9242 1208
robyn.curnow@ags.gov.au	
<b>Lydia Martin</b> <i>Lawyer</i>	03 9242 1432
lydia.martin@ags.gov.au	

**Brisbane**

<b>Baden Powell</b> <i>Senior Lawyer</i>	07 3360 5766
baden.powell@ags.gov.au	
<b>Sarah McLaughlin</b> <i>Lawyer</i>	07 3360 5778
sarah.mclaughlin@ags.gov.au	

**Perth**

<b>Lee-Sai Choo</b> <i>Senior Executive Lawyer</i>	08 9268 1137
lee-sai.choo@ags.gov.au	
<b>Mieke Dixon</b> <i>Senior Lawyer</i>	08 9268 1112
mieke.dixon@ags.gov.au	
<b>Carla Kovacevic</b> <i>Senior Lawyer</i>	08 9268 1105
carla.kovacevic@ags.gov.au	

**Adelaide**

<b>Dusan Uglesic</b> <i>Senior Executive Lawyer</i>	08 8205 4298
dusan.uglesic@ags.gov.au	

**Darwin**

<b>Angela Nanson</b> <i>Director AGS Darwin</i>	08 8943 1429
angela.nanson@ags.gov.au	