

We welcome you to the winter edition of our newsletter, which will focus on Charges and Trustee Liability.

We hope you find the following of interest. Should there be other insolvency related issues that you wish to see covered in future editions, then please let us know by return email, as this will assist in keeping our topics relevant to readers.

FIXED CHARGES AND TRADE CREDITORS

You would be aware that a fixed charge holder can exercise its rights over the charged fixed assets of a company in priority to all other creditors including employees.

OBP has been involved in the administration of an ASX listed company ("the Company") in which an unsecured trade creditor has made interesting use of a fixed charge to secure its existing and future debt. In this case, a major creditor ("the Creditor") was owed significant monies in respect of long outstanding invoices.

In addition, the Creditor was an integral part of the continued operation of the business of the Company by virtue of the provision of on-going services. When the Creditor received further significant orders from the Company, it became concerned about the extent of its potential exposure and as a consequence met with the Board of Directors of the Company and negotiated, in return for the continued supply of goods and services to the Company, the granting of fixed charges and cross guarantees & indemnities, over the fixed assets of the Company and its subsidiaries in respect to:

a) Current outstanding invoices;
and

b) Future debts, yet to be incurred.

The Company and its subsidiaries were placed into Voluntary Administration within six (6) months of the fixed charges being granted.

The assets of the group were sold and the Creditor was paid in full, in priority to employee claims, by the Administrator for the entirety of its debt, together with the costs associated with enforcing the charges.

However, the Liquidator was able to commence proceedings against the Creditor to recover the monies paid to it under the charges in respect of the pre-existing debt. The basis of the claim was that the debtor company went into liquidation within 6 months of the granting of the charges and thus the amounts paid under the charges which relate to amounts outstanding as at the date the charges were created, may be unfair preferences and voidable against the Liquidator.

However, it is generally accepted that the granting of a fixed charge in respect of future amounts, yet to be incurred, cannot be voided by a Liquidator. Accordingly, this allows a creditor to continue to supply its customer, with the knowledge that the pre-existing

debt may end up being secured whilst the value of goods and/or services supplied subsequently are secured against the charged fixed assets of the company.

Factors to be considered by both the debtor company in granting a fixed charge and the creditor in seeking a fixed charge include:

- i) Pre-existing charges over assets;
- ii) The negotiating power the creditor may have;
- iii) The value of the future orders to be placed with the creditor;
- iv) The forced sale value of the fixed assets to be secured;
- v) The solvency (or lack thereof) of the company who is to grant the charge in favour of the creditor.
- vi) The likely extent of employee entitlements in the event of insolvency.

This practice can also be extended to situations where a related party wishes to advance working capital or funds for a specific project to a company.

SECURED CREDITOR LOSES SECURITY

In a recent NSW Supreme Court decision, a creditor holding a fixed and floating charge was held to have surrendered her security, as a result of casting her vote at a creditors meeting. The creditor, a Mrs Cockerill, was a shareholder of a company that designed and manufactured uniforms. The company went into administration and subsequently liquidation.

Mrs Cockerill had lodged a statement of particulars of debt for the purposes of voting at a meeting of creditors, in which she stated that the value of the security (ie the value of the assets) was "not known".

During the liquidation and at a meeting of creditors, Mrs Cockerill voted in favour of an adjournment of the meeting, without knowing that by voting at the meeting she would have been taken to have surrendered her security.

As she had not included an estimate of the value of her security, the Court held that it must be accepted that she had voted in respect of the full amount of her debt. Under the Corporations Regulations and under a winding up, a secured creditor is entitled to vote only for the difference between the estimated value of the security and the amount of the debt.

A secured creditor who votes for the full amount of its debt is taken to have surrendered its security unless the Court is satisfied that the failure to estimate the value of the security is inadvertent. In this case, the Court held Mrs Cockerill's action in stating the value of her security as "not known" was due not to inadvertence, but to an inability to determine a value.

The case emphasizes the need for secured creditors to exercise their voting rights carefully in a liquidation, or risk being demoted to the status of an unsecured creditor.

TRUSTEE LIABILITY

Directors of corporate trustee companies have faced potential liability for the debts of insolvent trusts since the South Australian Full Supreme Court decision in Hanell v O'Neill in 2003.

That decision extended the circumstances in which a director of a corporate trustee company would be held personally liable under s 197(1) of the Corporations Act. Directors of

corporate trustees were regarded as effectively guaranteeing trust liabilities, in the event that there were insufficient assets available. The implication is that a director of a company which was the trustee of an insolvent trading trust could be potentially liable for any shortfall to creditors.

The Parliamentary Secretary to the Treasurer has announced that amendments would be made to

the Corporations Act to restore the traditional interpretation of the law and put the directors of trustee companies on the same footing as other directors. The amendments form part of the Corporations Amendment Bill (No 1) 2005, which has been introduced in the current sitting of Federal Parliament.

If you require further information regarding any insolvency related issue, then do not hesitate to contact us.

Contacts:

Chris Palmer
Michael Wayland
Andrew Cowled

cpalmer@obp.com.au
mwayland@obp.com.au
acowled@obp.com.au

Bryan Collis
Robert Ritchie
Jon Meyer

bcollis@obp.com.au
rritchie@obp.com.au
jmeyer@obp.com.au

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