INSOLVENCY LAW REFORM - MAJOR ISSUES

SOME RECOMMENDATIONS OF THE AUSTRALIAN LAW REFORM COMMISSION AFFECTING FINANCIERS

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[References in brackets are to paragraph numbers in Report No. 45 of the Australian Law Reform Commission in respect of the General Insolvency Enquiry]

1. RECEIVERS

1.1 Agents of the mortgagee

At least until the Commonwealth Parliament amends s.221P of the Income Tax Assessment Act and similar provisions or the definition of "trustee" in that Act the decision in Deputy Federal Commission of Taxation v. General Credits Ltd (1987) 5 ACLC 1003 will fortify the holder of mortgage debentures in their practice of appointing agents rather than receivers for the purpose of enforcing their securities. The Commission considered it anomalous that some provisions of Part X of the Code applied to both types of appointee whereas other sections in that Part apply only to receivers. [185, 186, 187]. Accordingly the Commission has recommended that all appropriate sections in that Part should apply not only to receivers but also to an agent of a mortgagee. [188].

1.2 Automatic crystallisation

Professor O'Donovan in his remarks describes the Commission's recommendations in respect of automatic crystallisation and observes that their implementation would remove one of the secured creditor's "trump cards". To adapt the Commission's remarks in relation to automatic crystallisation; a game quite unknown to Hoyle is one where a player is unaware that he holds a card. [191]. More importantly it should be noted that the Commission's recommendation in this regard is qualified by the suggestion of the need for a complete review of the priority provisions contained in the Code which it regards as unsatisfactory but beyond the terms of its reference. [199].

1.3 Appointment and conduct of receiver

(a) Validity of receiver's appointment and acts

Questions are raised from time to time in the course of a receivership as to the validity of the receiver's appointment or the propriety of his conduct. Accordingly the Commission has recommended that receivers be able to approach the court for appropriate declaratory relief. [203, 205].

(b) Provision of information

A matter of concern for unsecured creditors of a company to which a receiver is appointed is that not only does "the shutter go down" on the prospect of any immediate payment but, additionally, on the provision of information about the affairs of the company. The Commission has recommended therefore that receivers should have a responsibility to prepare and file with the Corporate Affairs Commission a report as to the company's affairs and other information in relation to it within two months of their appointment. [209].

(c) Relationship with prior fixed chargeholders

It may happen that a receiver is appointed in circumstances where, eg., real estate owned by the company is subject to a fixed charge which enjoys priority to the security held by the receiver's appointor and the value of that property is insufficient to discharge the claim of the fixed chargeholder. In such an environment attempts by the receiver to sell the company's business may be frustrated by the fixed chargeholder refusing to discharge its security otherwise than against payment of the full amount of its claim. The Commission has recommended that a receiver confronted by "financial blackmail" of that type should be able to invoke the aid of the court which, subject to protecting the interests of the fixed chargeholder according to their true value, may make such orders as are necessary to facilitate the sale. [213, 214].

(d) Liability of receivers

The liability of receivers for debts incurred by them in the course of their administration of companies is limited by s.324 of the Code to "debts incurred by him in course of the receivership ... for services rendered, goods purchased or property hired, leased, used or occupied". Whilst the Commission proposed an extension of this obligation in the Discussion Paper which it issued it considered that the commercial uncertainty which would be produced by its suggested amendment would outweigh any advantages which might have accrued. Accordingly it recommended no change to

the present law. [217]. However where a receiver is appointed to a company which prior to that appointment has leased either premises or equipment and the receiver does not terminate the agreement within 7 days of that appointment then the receiver will be personally responsible for the lease payments which fall due for that period of the receivership during which the company continues to be in possession of, use or control that property. In order that receivers might be protected from liability in circumstances, eg., where they are unaware of the existence of the relevant lease it is recommended that the court have a general power to relieve them from liability. [220].

(e) Agency for the company

Typically a receiver will be appointed to act as agent of the mortgagor company rather than as agent of the mortgagee. The particular benefit which is perceived as accruing in consequence of effecting appointments in this way is that it limits the exposure of receivers and their appointors especially where a decision is taken to continue the mortgagor company's business. In Gosling v. Gaskell [1897] AC 575 and decisions which have followed it such as Mercantile Credits Ltd v. Atkins (1985) 3 ACLC 485 it has been held that the appointment of a liquidator to the mortgagor company terminates the receiver's agency. A cautious receiver or mortgagee may decide that in that circumstance the business of the company should be discontinued notwithstanding the adverse impact of that decision on the general body of the company's creditors. Accordingly the Commission has recommended that subject to obtaining the consent of the liquidator or the approval of the court the receiver should be able to continue to act as the mortgagor company's agent. [222].

1.4 Termination of receivership

Whilst it is arguable that the general law adequately protects a corporation either where a receiver has been appointed under an invalid charge or has been invalidly appointed or where a receiver has been guilty of some misconduct, the Commission considers it to be desirable for a corporation's rights in such circumstances to be expressly stated in the legislation and has so recommended. [227]. Additionally it can occur that a company has been ordered to be wound up and a receiver continues in office and retains possession of all the company's assets to the exclusion of the liquidator notwithstanding that the receiver's appointor is more than adequately secured. Such an approach on the part of a receiver can delay unnecessarily the expeditious realisation of a company's assets where no sensible purpose can be achieved by their preservation. The Commission has recommended, therefore, that the court should have power (subject to protecting the interests of the secured

creditor) to order that possession of the company's property or part of it be delivered to its liquidator. [230].

1.5 Duties of receivers

The anomalous position which presently exists under the case law in this country where there is a distinction between the duties of receivers (who merely have an obligation to act bona fide) and mortgagees (who have an additional responsibility when realising secured property to obtain the best price reasonably available for the property) was considered by Professor Peter Butt in his article The Mortgagee's Duty on Sale 53 ALJ 172.

The Commission has recommended that there be a statutory duty imposed upon receivers which requires that charged property be "not sold at a price below the best price reasonably obtainable". [236, Draft Legislation R6(2)].

2. SUBORDINATION OF DEBTS

Agreements between creditors of a company, particularly its financiers, that their respective claims shall not rank pari passu on a liquidation of the company appear to have become increasingly predominant. Uncertainty has developed about the efficacy of such agreements as a result of the decision of the House of Lords in British Eagle International Air Lines Ltd v. Compagnie Nationale Air France [1975] 1 WLR 758 and the cases which have followed it. Whilst it may be arguable that the judgment of Southwell J. in Horne v. Chester & Fein Property Developments Pty Limited (1987) 5 ACLC 245 has adequately explained the extent to which the British Eagle case turned on its own peculiar facts, the Commission considered that the position should be made clear by legislation and has recommended the introduction of a provision reading:

> "Sections 440 and 441 do not prevent the payment of one creditor's claim being deferred until some other creditor's claim has been paid in full or in part."

[768, Draft Legislation P6]. This provision does not contain the same detailed stipulations as are found in s.510 of the US Bankruptcy Code. However, the Commission considered that the case law was developing in such a way prior to British Eagle as to properly leave the determination of the circumstances in which subordination would be permitted or imposed to the discretion of the court.

3. CLAIMS DENOMINATED IN A FOREIGN CURRENCY

Australian companies are increasingly engaged not only in foreign trade but also in raising finance off-shore.

Notwithstanding that there is invariably a delay between the commencement of an insolvency administration and the payment of dividends the Commission was not persuaded that there were good grounds for departing from the traditional approach of valuing claims against a company as at the date upon which its insolvency administration commenced. It has recommended, therefore, that the rule suggested in re Lines Bros Ltd [1982] 2 All ER 183 should be codified with the result that the conversion rate which should apply to claims denominated in a foreign currency is that prevailing on the date of the winding up order or, in the case of a voluntary liquidation, the date of the resolution for winding up. [811].