RECEIVERS AND THE CREDIT CODE — ISSUES FOR SUCCESSFUL RECOVERY (A CASE STUDY)

KEVIN DUNDO

Partner
Clayton Utz, Solicitors, Perth

My brief is to examine the insolvency issues raised by the appointment of the administrator by Ritz Car Dealers Pty Ltd and appointment of the receivers and managers by Oz Bank.

THE POWER TO APPOINT AN ADMINISTRATOR

Oz Bank has charges over Ritz Car Dealers Pty Ltd (Ritz Care Dealers) and Ritz Car Finance Pty Ltd (Ritz Car Finance). It appears, however, that another financier has financed part of Ritz Car Dealers used car business under a bailment plan so some of the used cars are not included in Oz Bank's charge over Ritz Car Dealers. Nevertheless, Oz Bank would probably be classified as a chargee with a charge over "the whole, or substantially the whole, of the property" of Ritz Car Dealers within the meaning of section 441A of the Corporations Law. To determine whether a charge is a "substantial charge", we should look beyond the value of the assets included in, or excluded from, the charge to the practical capacity of the chargee to carry on the business of the company through a receiver and manager. If the charge does not cover the key business assets of the company, it might not be classified as a substantial charge.

We need more information to decide conclusively whether Oz Bank is a substantial chargee of Ritz Car Dealers because we do not know how much of the used car business is financed by the bailment plan. But let us assume for present purposes that Oz Bank is a "substantial chargee" within section 441A.

As a substantial chargee, Oz Bank would have the power to enforce its charge (in relation to "all the property of the company subject to the charge"), but only if it enforces the charge "before or during the decision period".[1] The decision period is defined in section 9 of the Corporations Law to mean generally the period beginning on the day when the administrator was appointed and ending at the end of the tenth business day after that day. In other words, the decision period generally lasts for nine business days ***after*** the day on which the administrator was appointed.[2]

If the substantial chargee was given notice of the administrator's appointment as required by section 450A(3), the decision period began on the day of that notice and finished at the end of the tenth business day after that day.

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1 Section 441A(1)(b).

2 See *Mann v Abruzzi Sports Club Ltd* (1994) 12 ACLC 137.

In the present case, Oz Bank appointed receivers and managers under ***all*** its securities, including the charges over Ritz Car Dealers and Ritz Car Finance and the mortgage over Mary Jones' car yard in Sydney.

While Oz Bank would appear to have power under the Corporations Law to appoint receivers and managers to the two companies, it may not enforce the mortgage over Mary Jones' car yard, or the guarantee and mortgage over residential property of Jim and Jane Jones, without the leave of the court. As a director of Ritz Car Dealers, Mary Jones is entitled to the protection of section 440J of the Corporations Law. This may surprise practitioners who believe that the section merely places a restriction upon the enforcement of guarantees of directors and associates during the administration of the company. The definition of "guarantee" in section 440J(4) is couched in terms which are broad enough to catch a mortgage given by a director or associate even if it creates a joint liability with the company. This provision also imposes a stay on any enforcement action under a guarantee by a relative of a director.[3]

The court would probably be reluctant to grant leave to Oz Bank under section 440J to enforce the mortgage over the car yard as Mary Jones' co-operation and support may be needed by the administrator in carrying on the business of the companies under administration.[4] However, Oz Bank would be able to obtain a "freeze order" on Mary Jones' car yard under section 1323 if the secured property were in jeopardy.[5] Similar considerations apply to Jim and Jane Jones in regard to their guarantees and mortgage in favour of Oz Bank.

Oz Bank should not encounter any problems with the Consumer Credit Code in its appointment of the receivers and managers under its charges and its mortgage because these securities are not related mortgages or related guarantees within the meaning of the Code.

THE GROUNDS FOR THE APPOINTMENT OF THE RECEIVERS AND MANAGERS

Oz Bank is not entitled to appoint receivers and managers under its securities unless there has been an event of default. The documents do not stipulate that the appointment of an administrator is an event of default but perhaps they provide a broad definition of "insolvency event" which might justify the appointment of the receivers and managers. It should not be assumed, however, that Ritz Car Dealers is insolvent simply because an administrator has been appointed. The company is entitled to appoint an administrator under section 436A of the Corporations Law if, "in the opinion of the directors voting for the resolution to appoint an administrator, the company is insolvent, or is **likely to become insolvent at some future time**". In other words, an administrator may be appointed to a company which is not yet insolvent. Moreover, the appointment of an administrator does not, in itself, constitute a repudiation of Ritz Car Dealers' obligations under the mortgage debenture.[6]

There was no monetary default at the time of the appointment, but Oz Bank may be able to justify the appointment of the receivers and managers "if in the reasonable opinion of Oz Bank there is any significant change in circumstances of the company likely to affect its value". The appointment of an administrator is a significant change in the company's circumstances since the control of the company is placed in the hands of an administrator and the powers of the directors are suspended during the administration.[7]

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3 Section 440J(1)(a)(ii).

4 See *Stegbar Pty Ltd v Mayfield* (1993) 13 ACSR 354.

5 Section 440J(2).

6 *Smith v Deputy Commissioner of Taxation* (1996) 22 ACSR 221.

7 See Corporations Law, sections 437A, 437C.

The value of the companies' assets may well be reduced by the very fact of the administration. Given the fact that the majority of voluntary administrations (50%-55%) result in a winding up of the companies, it appears reasonable for Oz Bank to conclude that administration is likely to affect the value of Ritz Car Dealers.[8]

It may be more difficult to establish that an event of default has occurred in relation to Ritz Car Finance as it appears that that company is not under administration. Oz Bank would have to argue that the appointment of an administrator of the parent company, Ritz Car Dealers, constituted a significant change in circumstances of the subsidiary company, Ritz Car Finance, likely to affect its value.

There appears to be no clear event of default under Mary Jones' mortgage unless there are cross-defaults in the mortgage and the charges.[9]

If there is no event of default justifying the appointment of the receivers and managers, they will be liable in trespass because they have apparently entered into possession of the companies' premises. Oz Bank could also be liable for trespass as appointor.[10]

The receivers and managers may be able to gain some relief from this liability under section 419(3) of the Corporations Law if they believed on reasonable grounds that their appointment was valid. In any event, this section confirms that the appointor, Oz Bank, will remain liable for the invalid appointment.[11]

The right to appoint receivers and managers flows from the mortgage debenture itself and it must be found within the four corners of the document.[12] There is no implied right to enforce a fixed term loan just because it is in jeopardy.[13]

These problems could have been avoided if Oz Bank or the receivers and managers had applied under section 418A on a specific ground for a declaration that the appointment was valid.[14] The specific ground in this case could be the doubts surrounding the event of default. The court could declare the appointment and entry into possession to be valid on the specific ground stated in the application or some other ground.[15]

Oz Bank might also have considered referring the matter to the Banking Ombudsman to attempt to mediate a solution.

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8 See generally, K Lingard, *Bank Security Documents* (2nd ed, 1988), para 7.29, on material adverse changes as events of default.

9 As to cross-default clauses, see K Lingard, *Bank Security Documents* (2nd ed, Butterworths, 1988), paras 7.22 and 7.33.

10 *Re Goldburg (No 2)* [1912] 1 KB 606; *R Jaffe Ltd (in Liq) v Jaffe (No 2)* [1932] NZLR 195; *Benny v Canberra Advance Bank Ltd* (1991) 5 ACSR 55. Contrast *Velcrete Pty Ltd v Melsom* (1995) 13 ACLC 799 where the debenture holder was not held liable in trespass because there was no evidence that the receivers had acted as its agents.

11 Section 419(3)(e).

12 *Benny v Canberra Advance Bank Ltd* (1991) 5 ACSR 55; *Wrights Hardware Pty Ltd (prov liq apptd) v Evans* (1988) 13 ACLR 631.

13 *Cryne v Barclays Bank* [1987] BCLC 548.

14 As to the effect of this provision, see ALRC, *General Insolvency Inquiry Report No 45* (1988), para 201-205 and *Re Blackbird Pies (Management) Pty Ltd (No 2)* [1970] QWN 14; *Bank of New Zealand v Essington Developments Pty Ltd* (1991) 9 ACLC 1039.

15 Section 418A(2).

BREACHES OF CREDIT CODE OBLIGATIONS BY RECEIVERS AND MANAGERS

We are told that the receivers and managers run the finance company book for several months, collecting debts from borrowers of Ritz Car Finance without being aware of Credit Code obligations.

Receivers and managers appointed out of court are normally expressed to be the agents of the mortgagor or chargor company. This standard provision in mortgages and mortgage debentures is intended to protect mortgagees from incurring the liabilities of a mortgagee in possession when they appoint receivers and managers.

Under the Consumer Credit Code, a credit provider will be vicariously liable for the conduct of its officers, agents or employees acting within their actual or ostensible authority.[16] But Oz Bank, as an indirect credit provider, will not be liable for any actions taken by the receivers and managers before the winding up of the company unless it instructs or directs the receivers how to carry on the business.[17]

In the absence of such directions or instructions, the usual "agency" provision in the mortgage debenture will protect Oz Bank until the winding up terminates the agency between Ritz Car Dealers and Ritz Car Finance and the receivers and managers.[18]

Prior to the winding up, it is unlikely that Oz Bank would be liable as a person who aided, abetted, counselled or procured the commission of an offence or as a person who was in any way directly or indirectly concerned in the commission of an offence against the Code or the regulations.[19] Hence, Oz Bank would probably not incur liability as an accomplice under section 182 of the Code. When the winding up terminates the receivers and managers' normal agency, Oz Bank might be more exposed under section 182, particularly, if it gave the receivers and managers instructions or directions.

Section 183 casts the net even more widely. Where a contravention is committed by a corporation, each officer who knowingly authorised or permitted the contravention is taken to have contravened the provision. Hence, officers of Oz Bank could be held liable under the Consumer Credit Code if Oz Bank itself contravenes the Code. However, it is doubtful whether Oz Bank's in-house lawyers would be liable under this provision unless they were the motivating force behind the contravention.[20]

LIABILITY FOR LOSSES

We are told that the business traded at a loss. Until the winding up of the company, a receiver can incur debts which are provable against the company in liquidation. This is a consequence of the agency provision in the standard mortgage debenture.

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16 Section 176(1).

17 See *American Express International Banking Corporation v Hurley* [1985] 3 All ER 564; *Standard Chartered Bank v Walker* [1982] 1 WLR 1410.

18 See *Gosling v Gaskell* [1897] AC 575; *Atkins v Mercantile Credits Ltd* (1985) 4 ACLC 125; *Thomas v Todd* [1926] 2 KB 511. Cf *Re Leslie Homes (Aust) Pty Ltd* (1984) 8 ACLR 1020 at 1023, where McLelland J suggested that winding up neither terminates the agency nor prevents it from arising: it merely limits the receiver's agency so as to be consistent with the winding up.

19 See G Williams, *Criminal Law: The General Part* (2nd ed, 1961), paras 121 and 195.

20 See JD Heydon, *Trade Practices Law* (LBC Information Services, 1989), para 18.130.

However, when the company is wound up, this agency is terminated and the receivers and managers lose their authority to incur debts which are provable against the company in the winding up.[21]

In effect, this means that any losses incurred by the receivers and managers after the companies are wound up must be borne by the secured assets. If the secured assets are deficient, then the losses must be borne by the mortgagee itself because the receivers were, at that time, carrying on the business on behalf of a mortgagee as agents for the mortgagee in possession.[22] This fact should concentrate the minds of receivers and managers who carry on the business of a company at a loss. Once the winding up occurs, the secured assets and ultimately the secured creditor, will pick up the tab for losses incurred in carrying on the business.

Section 420C gives a receiver power to carry on the business of the company, with the written approval of the liquidator or the approval of the court, but it makes it clear that any debts or liabilities incurred by the receiver in carrying on the business are not costs and expenses of the winding up. Nor are these costs and expenses provable debts in the winding up.

CONCLUSIONS

(a) Oz Bank would probably be a substantial chargee with power to appoint receivers and managers during the decision period of 10 business days, commencing on the appointment of the administrator of Ritz Car Dealers.

(b) Oz Bank's appointment of receivers of Mary Jones' car yard in Sydney would be invalid as the leave of the court was required under section 440J. Leave might be granted retrospectively but it is unlikely to be granted in the present case if Mary Jones' co-operation is required during the administration.

(c) There were no clear events of default to justify the appointment of receivers in respect of Ritz Car Finance and Mary Jones' property, but there would appear to be an event of default in relation to Ritz Car Dealers in the form of the significant change in the circumstances of the company as a result of the appointment of the administrator.

(d) Oz Bank should have sought a declaration under section 418A in respect of the validity of the appointment of the receivers and managers.

(e) If the receivers and managers were invalidly appointed, they could be held liable in damages for trespass and so could Oz Bank.

(f) Oz Bank will not be liable for any breaches of the Consumer Credit Code by the receivers unless it instructed or directed the receivers in the conduct of the receivership. But, on winding up, Oz Bank may be liable for the receivers' acts or omissions because the agency clause in the mortgage debenture no longer protects Oz Bank.

(g) Upon winding up, the receivers and managers cannot incur losses which are provable against the company in liquidation. These losses must be borne by the secured assets or, if they are deficient, by the mortgagee, Oz Bank.

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21 *Gaskell v Gosling* [1896] 1 QB 669; *Mercantile Credits Ltd v Atkins (No 1)* (1985) 9 ACLR 757; *Atkins v Mercantile Credits Ltd* (1985) 4 ACLC 125.

22 See *Richex Industries Pty Ltd v Payne* (unreported Sup Ct Vic, 10 August 1990) and O'Donovan, *Company Receivers and Administrators* (2nd ed, Loose-Leaf Service), para 13.110.