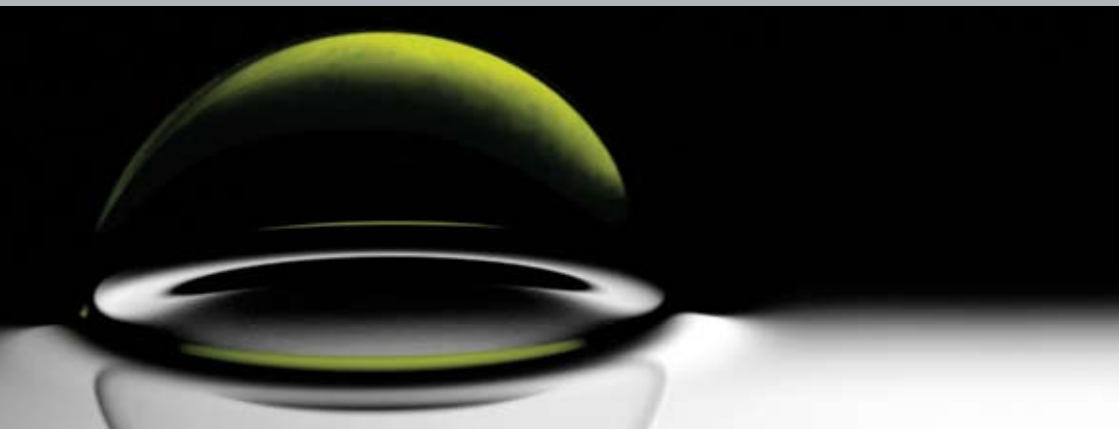


CLAYTON UTZ

Restructuring & Insolvency
Enforcing security rights



What are security rights?

A creditor is a secured creditor if it has an interest in nominated property which relates specifically to payment of a debt or performance of an obligation by the debtor. The property can be land or goods. The interest in the property is usually created by agreement between the creditor and debtor, although in some cases it can arise by operation of law; eg. the interests of local government in land if rates are not paid. Sometimes third parties are involved; eg. a third party mortgage given by a guarantor to secure a debt owed by the primary debtor.

Agreements between the parties usually provide that the creditor's interest in the property will terminate once the debt is paid or the obligation performed – the purpose of the security is to protect the rights of the creditor if this does not occur. Creditors with security rights over property of a debtor can be contrasted with unsecured creditors, who have no rights against specific property of the debtor if they are not paid, and must sue the debtor in court to enforce any rights they have.

Types of security

The enforceable rights of a secured creditor will vary according to a number of factors including the manner in which the security is created, and the type of property involved. Security rights are often regulated by State law, and, consequently, State variations may occur.

The most common form of security over land is a real property mortgage. The rights of mortgagees of land will depend on the terms of the mortgage, the relevant legislation, and the type of land involved; eg. general law land, Crown lease, or Torrens title land.

Security interests over goods vary greatly in form and include:

- bills of sale
- fixed and floating charges under the Corporations Act 2001
- security interests specific to certain goods such as stock mortgages
- liens on documents, specific goods and some crops
- registered security interests over motor vehicles and trailers.

Rights of secured creditors

Common rights of secured creditors

In the event of default in payment by the debtor, rights typically held by secured creditors are:

- the security is a mortgage over land – to take possession, exercise a power of sale, appoint a receiver, foreclose, and appoint an agent to perform actions on the mortgagee's behalf; and
- the security is over goods – to take possession of the chattel and exercise a power of sale.

Any amounts resulting from the creditor realising the security are generally applied first, to meet the remuneration of any appointee such as a receiver, second, to reduce any sums owed to the secured creditor and then to pay amounts owed to any subsequent secured creditors. Only once these avenues have been exhausted will any surplus be paid to the debtor.

Secured creditors also have the right to take legal action to enforce payment of outstanding money. This right generally exists, even where the secured property has not been realised.

Rights of priority and registration

The primary benefit of taking security is that the secured creditor has priority over unsecured creditors in accessing the property of the debtor. For example, if a secured creditor has a fixed charge over plant and equipment of a debtor and the debtor becomes insolvent, the secured creditor will have priority over all unsecured creditors in satisfying its debt from the proceeds of sale of that plant and equipment. The rights of priority over other creditors will depend however in many cases on whether the secured creditor has registered its security interest. A creditor who holds a charge over

corporate property which is registrable under the Corporations Act 2001 will not have priority over other creditors if the company is wound up, unless the charge is registered. It is therefore in the interests of creditors to take control of security documentation from the debtor and ensure that any necessary registration takes place. Further, a registrable charge which is not registered within 45 days of creation of the charge may be void as a security against a liquidator or administrator of a debtor company, although the creditor will be able to prove the debt as an unsecured creditor.

Notwithstanding the registration of security interests, there are many situations where a security will lose priority or be unenforceable by the creditor. A mortgage of land will be unenforceable if it was given by the guarantor in unconscionable circumstances or subject to undue influence. A charge over corporate property will be unenforceable if the secured creditor is an officer of the company and the creditor takes steps to enforce the charge within six months of creation. The holder of a floating charge will lose priority to employees of the debtor company if the company enters liquidation or a receiver is appointed by the chargee, unlike creditors with fixed charges who are not postponed to the employees.

Insolvency of the debtor

The insolvency of the debtor, as a general rule, does not prevent a secured creditor from enforcing its security or recovering the debt owing. Provided the security has maintained its value, the secured creditor may fully recover any amounts owing by the debtor by realising the property. The powers of a liquidator or trustee in bankruptcy are generally subject to the rights of a secured creditor. This may be subject, however, to a number of factors including whether the security interest has been registered, the identity of the creditor; eg. a director of the debtor company, and special legislative priorities such as those afforded to employees.

Rights of the secured creditor in the insolvency of the debtor

The most important right usually reserved to a secured creditor is the right to appoint a receiver over property subject to the security where the debtor defaults on payment or performance of its obligation. This is particularly important in the corporate context, although it is possible to appoint a receiver to property of a partnership or an individual. Receivers appointed to a corporation pursuant to a charge, known as privately appointed receivers, have extensive powers conferred on them by the Corporations Act 2001, and will also have powers under the agreement between the secured creditor and

the debtor company. Further, where the security is a mortgage over land, conveyancing legislation in all States allows mortgagees to appoint a receiver over the land to collect rent in the absence of specific provision in the mortgage itself.

Whilst such action attracts its own duties and potential liabilities, it is also common for a secured creditor to have the power to either enter into possession of the secured property as a "mortgagee in possession" or appoint an agent to take possession of it. All powers exercised by a mortgagee in possession derive from the agreement between the parties, making the proper drafting of the agreement an important issue.

Secured creditors with a fixed and floating charge over the whole or substantially the whole of a corporation's assets are empowered to make key decisions in the appointment and role of an administrator under Part 5.3 of the Corporations Act 2001. A creditor with this degree of security is able to appoint an administrator over the company if that security is enforceable. Further, if an administrator is appointed by anyone else, this type of creditor is permitted by the legislation to enforce its charge at any time up to thirteen business days from the date of the appointment. A creditor with a charge over the whole, or substantially the whole, of the corporation's assets can be contrasted with other secured creditors, who do not have these powers or options in relation to corporate property.

Choice of remedy

The rights of secured creditors and the remedies available to them are dependent upon the nature, extent and terms of the security held. The exercise of rights will, however, depend not only on the rights held, but also on tactical considerations relevant to the particular circumstances. For example, in some cases there may be factors compelling the appointment of a receiver and manager under a charge over all of the company's assets. In other circumstances it may be more advantageous to appoint an administrator or allow the debtor company to do so. Factors relevant to such a decision include:

- the possibility, or otherwise, of an administration permitting the company to be sold as a going concern preserving the company's ability to meet its debts
- fear of adverse publicity
- cost
- opposition to an appointment

- impact upon contractual rights
- whether the creditor perceives control is important in the relevant case.

In some circumstances, it may be advantageous for a secured creditor to sue the debtor and guarantors immediately on default for repayment of a debt rather than wait for realisation of the secured property. This would reduce the chance of the debtor and guarantors delaying proceedings and raising triable issues arising out of the realisation process. Such actions may also prevent dissipation of assets by the debtor.

The most advantageous manner of enforcing security rights should be considered in any given circumstance in light of the rights held and factors such as those outlined above.

Restructuring & Insolvency group publications

The Restructuring & Insolvency group of Clayton Utz has prepared a series of brochures that provide an outline of the operation of relevant areas of law.

The complete set of brochures in the series comprises:

- Deed of company arrangement
- Company receivers and managers
- Third party guarantees
- Retention of title clauses
- Voluntary administration
- Liquidation
- Provisional liquidation
- Enforcing security rights

Treatment of the topic addressed in each brochure though comprehensive is not exhaustive. Moreover, a proper understanding of any particular situation demands an integrated approach. Clayton Utz is available to give advice over the whole range of issues relating to corporate restructuring and insolvency, including the position of secured and unsecured creditors, and the practical issues relating to enforcement of securities and debt recovery, structuring and restructuring transactions and litigation.

Copies of this brochure and the others referred to can be obtained free of charge from the Restructuring & Insolvency group of Clayton Utz.

Sydney
Level 34
No. 1 O'Connell Street
Sydney NSW 2000
T +61 2 9353 4000
F +61 2 8220 6700

Melbourne
Level 18
333 Collins Street
Melbourne VIC 3000
T +61 3 9286 6000
F +61 3 9629 8488

Brisbane
Level 28
Riparian Plaza
71 Eagle Street
Brisbane QLD 4000
T +61 7 3292 7000
F +61 7 3221 9669

Perth
Level 27
QV1 Building
250 St. George's Terrace
Perth WA 6000
T +61 8 9426 8000
F +61 8 9481 3095

Canberra
Level 8
Canberra House
40 Marcus Clarke Street
Canberra ACT 2601
T +61 2 6279 4000
F +61 2 6279 4099

Darwin
17–19 Lindsay Street
Darwin NT 0800
T +61 8 8943 2555
F +61 8 8943 2500

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