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INSOLVENCY



Inside:

**Privy Council rules
on the issue of
uncollected book
debts in *Agnew vs
Commissioner of
Inland Revenue (UK)***

Two recent rulings – October 2001

Two recent rulings set some important precedents in relation to insolvency issues. One relates to an insolvency matter of a high profile local retailer while Ben Dunstan, a lawyer with the Litigation & Dispute Resolution department, reviews an important ruling from the Privy Council in the United Kingdom.

Barrymores v Harris Scarfe [2001] WASC 210

A recent decision of the Supreme Court of Western Australia held that s440C of the *Corporations Act* protects receivers from conversion claims by the owner of goods subject to retention of title where the company is under administration at the time.

The history of the dispute

Barrymores was a regular supplier of children's wear to the major retailer Harris Scarfe. In April 2001, Harris Scarfe entered into voluntary administration and receivers and managers were subsequently appointed by a secured creditor.

Barrymores sought to exercise its rights under a retention of title (ROT) clause that formed part of its terms of sale to Harris Scarfe. The clause provided that Barrymores was to retain ownership of the goods until the full purchase price for the goods had been paid. Barrymores demanded from the receivers the immediate return of all its unsold goods in the possession of Harris Scarfe.

This demand was resisted by the receivers, who intended to sell the goods as part of a business sale and sought to negotiate acceptable terms. These negotiations failed and Barrymores sought a Court order for return of the goods.

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The court case

Barrymores also claimed damages for conversion against the receivers in respect of the goods on the basis that the receivers, in failing to return the goods to Barrymores upon request, had dealt with the goods in a manner that was inconsistent with Barrymores' right to possession.

The receivers argued that Barrymores had no right to immediate possession of the goods due to the fact that the company was in voluntary administration as well as receivership. It was argued that because of the administration, s440C of the Corporations Law (now the *Corporations Act*) applied and this was justification to deny Barrymores a right to immediate possession of the goods. Section 440C provides that an owner of property in the possession of a company under administration is prohibited from recovering possession of that property, except with the administrator's written consent or by leave of the Court.

As no such consent or leave had been given at the time of the receivers' refusal to deliver the goods, the receivers submitted that Barrymores was incapable of asserting a right of possession. In dealing with this issue, the Court recognised that a receiver may be personally liable in conversion, stating that:

"A receiver is not able to sell goods which the company has brought under a contract providing for retention of title by the vendor until they have been paid for in full. Where a receiver refuses to deliver up goods the subject of a valid ROT clause the receiver will be liable to the owner in conversion and exemplary damages may be awarded."

However, the Court also considered the fact that the company was in voluntary administration. In accepting the defence of the receivers, the Court found that:

"Here the receivers have a right to possess the goods as against all the world – including Barrymores, unless and until Barrymores obtain the administrators' written consent or leave of the court under s440C of the Corporations Law. It is only on either of those eventualities that Barrymores would have a legally enforceable right to immediate possession. At the time of the alleged conversion, Barrymores had neither the necessary written consent nor the leave of the court; an action in conversion does therefore not lie against the receivers."

The precedent

This decision is the first to consider the issue of conversion when a company is under receivership and administration simultaneously. It sounds an important warning for suppliers of goods subject to retention of title clauses.

Agnew v Commissioner of Inland Revenue [2001] UK PC 28 (5 June 2001)

Uncollected book debts?

The question in this appeal to the Privy Council was whether a charge over the uncollected book debts of a company which leaves the company free to collect them and use the proceeds in the ordinary course of business, is a fixed charge or a floating charge. Specifically, whether the company's right to collect the debts and deal with their proceeds free from the security meant that the charge on the uncollected debts, which was described in the debenture as fixed, was nevertheless a floating charge until it crystallised by the appointment of the receivers (note that under section 9 of the *Corporations Act* a floating charge is defined as "includes a charge that conferred a floating security at the time of its creation but has since become a fixed or specific charge)."

The ruling

Ultimately, the Privy Council found that as the company retained the power to extinguish the assets which were the subject of the fixed charge and replace them with assets the subject of the floating charge, the charge over the book debts was a floating charge.

Council's reasoning

In reaching this conclusion, the Privy Council reviewed and discussed the differences between the fixed and floating charge in the context of book debts and noted, in the context of a charge over book debts, compliance with the terms of a fixed charge on a company's circulating capital would paralyse its business. The Privy Council also conducted a detailed analysis of decisions dealing with the definition descriptions of a floating charge in the context of book debts and from those cases distilled the principle that the critical feature of a floating charge in relation to book debts was a company's freedom to receive the book debts for its own account and to deal with the proceeds without reference to the charge holder.



Previous rulings

The Privy Council found that, a previous decision of the English Court of Appeal in *Re New Bullas Trading Limited* (1994) 12 ACLC 3203 had been wrongly decided. In *New Bullas* it was held that a charge which was expressed to be fixed over book debts but floating over the proceeds of the book debts was valid.

The Privy Council found that a principal theme of the decision in *New Bullas* was that the parties were free to make whatever agreement they liked.

It was clear from the descriptions which the parties attached to the charges that they had intended to create a fixed charge over the book debts while they were uncollected and a floating charge over the proceeds. It was open to the parties to do so, and freedom of contract prevailed.

In *Whitton v ACN 003 266 886 Pty Limited* (1996) 42 NSWLR 123, Justice Bryson of the New South Wales Supreme Court in following *New Bullas* accepted the “freedom of contract” was a proper basis on which to ascertain the character of a charge.

The Privy Council also rejected the divisible asset theory which had been the guiding principle of decisions such as *New Bullas*. (The divisible asset theory provides that a debt and its proceeds are two separate assets.) This approach was also taken by the five member bench of the Full Court of the Federal Court of Australia (sitting on appeal from a Full Court of the Australian Capital Territory) in *NZI Capital Corporation v William Hamilton* No. AG37 of 1994, where their Honours found:

“The cheques or cash or other means used to pay the debts have no relevant legal character independently of the debt themselves. It would be an extraordinary result if a creditor who has no charge over a company's book debts, nevertheless has a charge over the monies paid to the company in discharge or reduction of them.”

The Privy Council expressed it as follows:

While a debt and its proceeds are two separate assets, however, the latter are merely the traceable proceeds of the former and represent its entire value. A debt is a receivable; it is merely a right to receive payment from the debtor. Such a right cannot be enjoyed in specie; its value can only be exploited by exercising the right or by signing it for value to a third party. An assignment or charge of a receivable which does not carry with it the right to the receipt has no value. It is worthless as a security.

The Privy Council acknowledged that a fixed charge could be created over book debts but this result would only be obtained where the “degree of sequestration of the book debts when collected made those moneys incapable of being used in the ordinary course of business and meant they were put, specifically and expressly, at the disposal of the bank” (see *Re Keenan Bros Ltd* [1986] 12 BCLC 242).

What the decision means in an Australian context

Although decisions of the Privy Council are not binding on Australian courts they are extremely persuasive and an Australian court would be reluctant not to follow this decision.

What the decision means:

1. Fixed charges over book debts will in fact be floating charges if the chargee can in effect exercise complete control over:
 - (a) the collection of the book debts and the proceeds;
 - (b) the proceeds of the book debts.
2. Banks should review their existing charge documents.
3. Lawyers should review and revise their charge precedents.
4. Insolvency Practitioners should consider whether payments made by them consistent with *New Bullas* can be undone as moneys paid under a mistake of law, assuming that this decision will be followed in Australia.
5. Administrators, receivers and liquidators should obtain legal advice on the effect of charges.



This publication is intended only to provide an alert service on matters of interest to readers. As matters differ according to their facts, you should seek legal advice on specific situations as they arise.



For further information please contact:

Geoffrey Rankin

Team Leader
Partner, Brisbane
+ 61 7 3334 3235
Geoffrey.Rankin@aar.com.au

Michael Quinlan

Deputy Team Leader
Partner, Sydney
+ 61 2 9230 4411
Michael.Quinlan@aar.com.au

Lampros Vassiliou

Partner, Bangkok
+ 66 2 679 1333
Lampros.Vassiliou@aar.com.au

Tania Cini

Partner, Melbourne
+ 61 3 9613 8574
Tania.Cini@aar.com.au

Steven Cole

Partner, Perth
+ 61 8 9488 3743
Steven.Cole@aar.com.au

Sydney
Melbourne
Brisbane
Perth
Gold Coast
Port Moresby
Singapore
Hong Kong
Jakarta
Shanghai
Bangkok
Phnom Penh