



**CLAIMS BY SHAREHOLDERS
AGAINST INSOLVENT COMPANIES:
IMPLICATIONS OF THE SONS OF GWALIA
DECISION AND THE CAMAC REPORT**



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The Corporations and Markets Advisory Committee (CAMAC) backed a High Court decision that ranks shareholders equally with all other creditors for seeking damages in failed companies if they had relied on false or misleading information at the time of their share acquisition. The decision fundamentally erodes the traditional position that shareholders' interests in liquidation would always be postponed behind conventional creditors.

In the current economic climate:

- Corporations should review their corporate governance policies to ensure all appropriate disclosures are made to the market
- Unsecured creditors should consider the increased risks they may face of potentially lower distributions where an insolvent company has a large number of claims by shareholders
- Financiers should factor in possible aggrieved shareholder claims in providing unsecured debt to distressed companies and as a result obtain appropriate increased security and higher equity ratios

The Sons of Gwalia decision ¹ considered the issue of how claims for damages by aggrieved shareholders should rank in voluntary administrations or liquidation.

Eleven days after the plaintiff shareholder, Margaretic purchased shares in Gwalia (a gold mining company), administrators were appointed to the company. Margaretic claimed that Gwalia had misled and deceived him at the time he purchased the shares as Gwalia failed to inform the market, via its statutory continuous disclosure obligations, that it had insufficient gold reserves to meet its gold delivery contracts.

The High Court agreed with Margaretic and held a claim by a shareholder for loss to the value of shares caused by failure of the company to inform the market, which would rank equally with the claims of other unsecured creditors in an external

administration. Margaretic's claim was not in his "capacity as a member of the company" which would usually be postponed behind claims by unsecured creditors.

CAMAC endorsed the decision in its recent report and recognised that shareholders and creditors share an interest in the promotion of an efficient and informed market.

While there may be limited instances, these circumstances tend to involve publicly listed companies and the amount at stake is usually large.

It is not unrealistic to expect lenders to factor into the risk of lending to Australian companies, particularly listed public companies, the possibility that aggrieved shareholders may compete with unsecured creditors in the event that the company goes into external administration. This may influence the readiness of financiers to lend or the terms on which they will do so, especially against the current background of an already tight credit market.

For further information regarding the possible implications for you or your business, contact Russell Kennedy's Kaajal Fox or Sebastian Saccuzzo.

¹ Sons of Gwalia Ltd v Margaretic [2007] HCA 1

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OCTAVIAR DECISION EXTENDS CHARGE VARIATION REGISTRATION REQUIREMENTS



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The Supreme Court of Queensland's decision in March 2009 may force the way the market deals with variations in liabilities secured by registered charges, in particular, the notifications required to be lodged at the Australian Securities and Investment Commission (ASIC). This may have significant implications on those relying on the effectiveness of charges securing existing financial obligations.

Octaviar Ltd: Re Octaviar Administration Pty Ltd [2009] QSC 37 (the Octaviar decision)

Most lenders are aware that to rely on the protections afforded under the Corporations Act, registrable charges over the assets of a company must be lodged with ASIC within 45 days of the creation of the charge. What may be less clear is a similar requirement which arises in relation to variations of an existing charge if the variation:

- increases the amount of the debt or the liabilities secured by the charge
- prohibits or restricts the creation of subsequent charges on the property

One of the issues decided in the recent Queensland decision of Octaviar¹ was that, where an existing charge had been varied with no notification lodged at ASIC, the charge was partially invalid to the extent of the increase of liability it secured.

Octaviar Case

A guarantee was given by Octaviar Limited in favour of Fortress Credit Corporation to support the borrowings of a third party. Octaviar had also borrowed money from Fortress and gave a charge over its assets to secure that loan. Subsequently the loan to Octaviar was repaid in full. The parties then agreed that rather than releasing the charge, the charge would thereafter be regarded as security for the guarantee given by Octaviar for the third party loan.

The parties signed a letter agreeing that the guarantee previously given by Octaviar was a **Transaction Document** and that the charge given by Octaviar secured the guarantee given by it for the third party loan.

No notification of this variation to the terms of the charge was given to ASIC, nor was any amendment made to the charge itself.

Section 266(3) of the Corporations Act provides that:

- If a charge is varied by increasing the debt or liability secured by it; and
- If the notice of variation is not lodged at ASIC within 45 days or within any extension by the Court; and
- If the company which gave the charge goes into liquidation or administration within 6 months of the date of such variation; then the charge is void as security to the extent that it secures the amount of the increase of the debt or liability secured.

The court stated that the designation of the guarantee as a **Transaction Document** was a variation of the charge which increased the liabilities secured by the charge, in that it added a liability which was previously unsecured.

Justice McMurdo commented that the failure to notify of the designation of a document under the legislation, could 'leave the public completely uninformed of a variation to a registered charge, which might have resulted in an important change to the reach of the charge by the addition of a distinct and substantial liability'.

The impact of the Octaviar decision

What is the common practice of lenders to notify ASIC of changes in secured liabilities under section 268 of the Corporations Act? Do they usually provide notification only when there has been a change in the terms of the registered charge that directly amends the definition of the liabilities secured? Often, as in the present case, the secured liabilities are defined broadly in a way that permits the inclusion in the secured liabilities of further obligations through a nomination mechanism, without any change to the terms of the charge. In this respect, the secured liabilities are analogous to **all moneys** mortgages, under which all moneys owed by the chargor to the chargee for whatever reason are secured by the mortgage.

In circumstances where the use of a provision has the result of varying the liability or obligation secured by a registered charge or the underlying commercial arrangements which may have the effect of increasing the secured liabilities, the requirements of section 268(2) may be triggered even though there is no change in the amount secured by the charge itself or no change to the terms of the relevant security instrument itself.

Mortgages that secure **all moneys** are treated differently under section 268(3) of the Corporations Act, which specifically provides that an advance under a charge securing a debt of 'an unspecified amount' is not an increase of the secured liabilities for the purposes of section 268(2).

Where to from here....

Subject to any successful appeal of this decision, a prudent course of action for secured lenders to take is:

- Review and identify registered or registrable charges whose definition of "secured money" (or its equivalent) is document specific as opposed to **all moneys** charges. If there have been variations, limits increased, new facilities added or the designation of new documents as **Transaction Documents**, consider lodging a ASIC Form 311B with ASIC in respect of those variations or additional documents
- If more than 45 days has elapsed since the date of the relevant variation, increased limit or designation of a new document, consider lodging the ASIC Form 311B as soon as possible so that the **six month waiting period** under

section 266(3)(c)(i) of the Corporations Act may commence. In certain circumstances it may be necessary to seek leave of the court to extend the period for notification, as contemplated under section 266(4) of the Corporations Act.

For new secured finance transactions, lenders may wish to describe the nature of the secured obligations in some degree of detail in the security document itself. Perhaps obtaining **all moneys** securities may be a preferable solution to the issues raised in the Octaviar decision.

We will provide a follow up bulletin if an appeal is decided.

In the meantime, contact Russell Kennedy's Kaajal Fox or Sebastian Saccuzzo for further information and advice.

¹ Re Octaviar Ltd: Re Octaviar Administration Pty Ltd [2009] QSC 37

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MORTGAGE FORGERY – WHERE TO NOW FOR MORTGAGORS?



HELEN MASTOS, Senior Solicitor

Indefeasibility of title enshrined in section 42 of the Transfer of Land Act has long been recognised as extending to the title of a registered mortgagee, except when there has been actual fraud on the part of that mortgagee. However, this has not prevented mortgagors from testing this principle in cases where their signature on a loan agreement and mortgage has been forged.

Previous court decisions have largely turned on the specific wording of mortgages.

The New South Wales Supreme Court has found that indefeasibility of a registered mortgage does not extend to a separate loan that was not expressly incorporated into the mortgage, as there was no debt secured by the mortgage due to the forgery.

However, where there are co-borrowers and liability under the loan is **joint and several**, and the signature of one joint proprietor had been forged by the other, the definition of **secured money** contained in the mortgage operated to secure the indebtedness of the **innocent** joint proprietor. (Perpetual Trustees Victoria Limited v Cipri [2008] NSWSC 1128).

In the recent Victorian Supreme Court decision in Solack v Bank of Western Australia Limited & Ors [2009] VSC 82 (17 March 2009), the Court considered the NSW decisions and simplified the position. Mr Solack's signature was forged on the loan agreement, mortgage and other documents relating to the loan and mortgage. He relied on the NSW cases in his contention that the indefeasibility conferred by registration of the mortgage does extend to secure any indebtedness arising out of the forged loan agreement where the mortgage itself does not incorporate any covenant to pay.

The Court found that the covenant to pay was within the mortgage itself by virtue of the incorporation of the memorandum of common provisions in the mortgage, which in turn, incorporated the loan agreement.

It appears that in Victoria, a mortgagor whose signature has been forged within a loan agreement and a mortgage is unlikely to achieve a favourable outcome in Supreme Court proceedings. The mortgagee's interest is not likely to be defeated in these circumstances.

A mortgagor in this position may receive legal advice to apply to VCAT to reopen the transaction pursuant to section 70 of the Uniform Consumer Credit Code (UCCC). As the power to exercise jurisdiction under the UCCC in Victoria vests exclusively in VCAT, a mortgagor cannot rely upon section 70 in any Supreme Court proceeding and separate proceedings will be required.

This process serves a dual purpose. Firstly, it would delay and frustrate any Supreme Court proceeding by a mortgagee, as the Supreme Court is likely to wait until the conclusion of VCAT proceedings before it makes any determination with respect to a mortgage. Secondly, the involvement of VCAT may be a factor ultimately influencing the way in which a mortgagee approaches any settlement negotiations.

In Perpetual Trustees Victoria Limited v van den Heuvel & Anor [2009] NSWSC 5 (20 February 2009), the Court held that as the wife's signature was forged, she did not enter into any loan agreement or a mortgage and was therefore not a borrower or mortgagor. Accordingly, the UCCC did not apply to her and the relief described in section 70 was not available to her. Hence, New South Wales decisions in circumstances involving forgery, indicate that the UCCC cannot be relied upon.

These decisions have not yet been considered by either VCAT or the Victorian Supreme Court on appeal. It remains to be seen what approach will be taken in Victoria when a borrower or mortgagor whose signature has been forged, seeks some relief under provisions of the UCCC.

For more information regarding the possible implications for you or your business or for details of the decisions, contact Helen Mastos or Paul McCarthy.

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OUR COMMITMENT TO THE COMMUNITY

Kaajal Fox, Banking & Finance Solicitor, was recently appointed to the Committee of Management of the Wyndham Legal Service Inc and has assumed the position of Treasurer within the Committee.

The Wyndham Legal Service is a community based legal service that provides free, accessible and equitable legal services to people who live, work or study in the Wyndham area who are disadvantaged in their access

to justice. The service provides a range of legal options including information, advice and casework, community legal education, law reform, advocacy and community projects.

The Wyndham Legal Service assists residents in the Werribee, Hoppers Crossing, Wyndham Vale, Little River, Tarneit, Truganina, Point Cook, Werribee South, Williams Landing and Balliang East areas.

WELCOME TO THE TEAM



Cameron Cox

Cameron is an experienced commercial litigation and dispute resolution solicitor. He advises on the recovery of secured and unsecured debt, the enforcement of

mortgage and other securities, bankruptcy, insolvency and has experience in large scale defended proceedings in all jurisdictions. He has a keen interest in appearance work.

Prior to joining Russell Kennedy, Cameron was employed for several years in a boutique firm providing a broad range of litigation services, including mortgagee recoveries, building and construction disputes and contract litigation. Cameron was responsible for the majority of court appearances at his former firm.

In his spare time, Cameron enjoys playing indoor soccer, known as 'futsal', in which he keeps goal (and has the bruises to show for it). Cameron played golf competitively in his youth, but these days enjoys having a casual hit with friends on the weekend.



Matthew Tennant

Matthew is a recent addition to the Banking and Finance litigation team at Russell Kennedy. He is a commercial litigation solicitor who practices in the area of finance litigation and contractual and commercial disputes.

In this capacity, he advises on debt recovery, insolvency and the effective realisation of secured assets.

Matthew has experienced a broad range of legal areas including building and construction, property and general commercial advisory work. He has had involvement in cases heard in all the major Victorian and Federal courts, including the Victorian Supreme Court, Court of Appeal, the Federal Court and the Victorian Civil and Administrative Tribunal.

With a keen interest in fitness, Matthew has competed for Russell Kennedy in the Law Institute of Victoria fun run, Around the Bay in a Day and the BRW Corporate Triathlon. He is also a proud member of the Melbourne Football Club and the Williamstown CYMS Football Club.

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