

Priority of the liquidator's lien

Melissa Tovey reports on *Stewart v Atco Controls Pty Ltd (In Liquidation)* [2014] HCA 15

Introduction

In *Stewart and Anor v Atco Controls Pty Ltd (In Liquidation)*, the High Court has re-affirmed the well-established principle that voluntary administrators,¹ provisional liquidators² and official liquidators³ are entitled to an equitable lien in respect of remuneration and expenses properly incurred in preserving and realising the company's assets, and that such lien will take priority over a secured creditor's claim on a fund realised by the insolvency practitioner.

Background

Newtronics was a wholly owned subsidiary of Atco. Atco provided financial support to Newtronics and took a fixed and floating charge over its assets. Between 1993 and 2001, Atco provided financial support to Newtronics, including letters of support promising to provide funds to allow it to meet Newtronics' trading obligations, and further promising that it would not call upon the debt owed within the relevant period to the detriment of unsecured creditors (the representations). As at December 2001, prior to Newtronics being wound up, it was indebted to Atco in the sum of \$19 million.

In January 2002, Atco appointed receivers to Newtronics after it was ordered to pay damages of \$8.9 million to a former customer, Seeley International Pty Ltd (Seeley). The receivers sold the business of Newtronics to another subsidiary of Atco for \$13 million, paid by way of a loan account adjustment against the funds advanced by Atco to Newtronics, such that no amount was actually received by Newtronics.

In February 2002, Newtronics was wound up on the application of Seeley; James Stewart was appointed as liquidator. The liquidator obtained funding, pursuant to an indemnity agreement with Seeley, to bring proceedings against Atco alleging that it was not entitled to the loan account adjustment or to enforce its security, as a result of the Representations.

Initial proceedings

In 2006 Newtronics commenced proceedings against Atco and later that year joined Atco's receivers, alleging they had been improperly appointed and had therefore converted Newtronics' property. Newtronics succeeded against Atco at trial but failed against the receivers. Atco brought an appeal against the trial judge's decision; on the day that appeal was to be heard the receivers settled with Newtronics and agreed to pay it \$1.25 million (the fund). The appeal otherwise proceeded and the trial judge's decision was overturned, the Victorian Court of Appeal holding that Atco's security was valid.

In September 2009, the liquidator of Newtronics received

the fund from the receivers and proceeded to pay the fund to Seeley, as a reimbursement to Seeley of funds it had provided the liquidator pursuant to the indemnity agreement.

Atco demanded that the fund be paid to it as it was an asset of Newtronics that was caught by Atco's charge. The liquidator refused to pay the fund to Atco, claiming an equitable lien over it which operated to defeat Atco's charge, at least in relation to the fund.

Proceedings below

Atco brought proceedings under s 1321 of the *Corporations Act* as a person aggrieved by the liquidator's decision. The proceedings were initially heard by an associate judge, who upheld Atco's claim and ordered the liquidator to pay the fund to Atco.⁴ On an appeal from the associate judge's decision, Davies J found for the liquidator.

Atco appealed to the Victorian Court of Appeal, which reversed the decision of Davies J, ordering Newtronics to pay the fund to Atco. The court held that no equitable lien arose in favour of the liquidator over the settlement sum, finding in particular that the liquidator, in bringing the proceedings against Atco and its receivers, was acting at all times in the interests of a third party and against the interests of Atco, and more specifically, Atco's security, which was a relevant consideration as to whether it would be unconscionable of Atco to claim the settlement sum.

The High Court

The principal issue for determination was whether the well-established and recognised equitable lien that arises in favour of insolvency practitioners, enunciated by Dixon J (as his Honour then was) in *In re Universal Distributing Co Ltd (In Liq)*,⁵ applied to the fund so as to allow the liquidator to assert a lien in priority to the secured claim by Atco.

The principle in *In re Universal* is that where a secured creditor participates in a winding up in order to discharge the relevant security, the secured creditor is entitled to receive principal and interest in priority to the general costs and expenses of the liquidation – but the costs of realising the assets, by the liquidator in this case or another practitioner generally, must be borne by the assets themselves. Put another way: a secured creditor should not get the benefit of having assets of the company realised in order to pay out the security, without that creditor having to pay the cost of that realisation.

The court was of the view that the *Universal Distributing* principle should apply to the facts of this matter and in coming to that view addressed the arguments advanced by Atco to the

Court of Appeal. The principle argument put by Atco below was that as the proceedings that realised the assets (which had resulted in the creation of the fund) had not been in Atco's interests, it would be unconscientious for the liquidator to retain the fund to meet his claim for an equitable lien.

The High Court identified three main grounds upon which Atco relied in the Court of Appeal to distinguish this matter from one to which the *Universal Distributing* principle should apply:⁶

- that a challenge to Atco's security was involved;
- that the proceedings were not brought to pursue Atco's interests as a secured creditor; and that the proceedings were in fact in the interests of Seeley.

In accepting those submissions, the Court of Appeal came to the view that the appropriate test was whether Atco would be acting unconscientiously if it were to receive the fund without meeting the costs of its creation.⁷ The Court of Appeal accepted Atco's submission that it had not willingly participated in the creation of the fund and that it had not 'come in' to the liquidation by proving and surrendering its security, factors which should distinguish *Universal Distributing*.

The High Court found that the reference to 'com[ing] in' in *Universal Distributing* is not a technical term and simply means a secured creditor who makes a claim against a fund created by the actions of a liquidator in realising assets.⁸ Moreover, the subjective intention of a liquidator in bringing proceedings to recover an asset is not relevant in applying the *Universal Distributing* principle.⁹ Accordingly, Atco's resistance to, and lack of participation in the creation of the fund was not relevant to the application of the principle.

The High Court emphasised that the proper, and perhaps only, enquiry which flows from the *Universal Distributing* test is whether the remuneration the subject of the asserted lien was generated in the getting in or realisation of the assets which in turn create the fund.¹⁰ The High Court also rejected an argument by Atco that no lien could have arisen at equity at the time of creation of the fund as the liquidator had been paid his costs and expenses under the indemnity agreement by Seeley. The court held that that argument ignored the obligation of the liquidator, under the indemnity agreement, to repay to Seeley any amount paid by it under that agreement. Similarly, Atco's argument that a clause in the indemnity agreement purporting

to engage s 564 of the Corporations Act (which provides a court with power to make orders regarding the distribution of property which has been recovered under an indemnity for costs of litigation that give the creditors providing the indemnity an advantage over others, in consideration of the risk assumed by them) was held not to prevent a lien arising, because it was inapplicable to the interests of third party creditors.¹¹

Ultimately, the High Court emphasised that the nature and purpose of an action brought by a liquidator to get in or realise assets, which in turn create a fund, is irrelevant to the determination of whether an equitable lien will arise in priority to a secured creditor's claim.

The liquidator's statutory duty to get in and realise assets is one which exists independently of, and is not subject to, the wishes or demands of any one or more creditors, secured or otherwise. Even to the extent that proceedings may be said to be in the interests of one creditor only (here Seeley), that *per se* will be insufficient to prevent an equitable lien arising.¹²

It remains the case that secured creditors who wish to challenge the priority of a liquidator's equitable lien will have to establish that the work carried out by the liquidator was not referable to the getting in or realisation of the assets which ultimately create the fund against which the secured creditor makes a claim. It similarly remains the case that a secured creditor laying claim to a fund created by the actions of a liquidator in realising assets will be 'coming in' to the liquidation within the meaning of *Universal Distributing*, regardless of the creditor's attitude to the conduct of the liquidator in getting in the fund.

Endnotes

1. Section 443F of the *Corporations Act 2001* (Cth) creates a statutory lien over the company's assets generally for the balance of their remuneration and properly incurred costs and expenses, but that statutory lien is subject to the priorities specified in s 556 of the Corporations Act.
2. *Shirlaw v Taylor* [1991] FCA 415.
3. *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171 at 174.
4. *Atco Controls Pty Ltd v Stewart (in his capacity as liquidator of Neutronics Pty Ltd (In Liq))* unreported, Supreme Court of Victoria (Commercial and Equity Division), 20 April 2011.
5. (1933) 48 CLR 171 at 174.
6. *Stewart and Anor v Atco Controls Pty Ltd (in liq)* [2014] HCA 15 at [29].
7. *Ibid.*, at [30].
8. *Ibid.*, at [37].
9. *Ibid.*, at [40].
10. *Ibid.*, at [41].
11. *Ibid.*, at [56].
12. *Ibid.*, at [61].