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## INSOLVENCY ALERT

### GOOD NEWS FOR LIQUIDATORS: HIGH COURT UPHOLDS THE *UNIVERSAL DISTRIBUTING* PRINCIPLE ON PRIORITY OF LIQUIDATORS' LIENS AS AGAINST SECURED CREDITORS

8 MAY 2014

On 7 May 2014, the High Court handed down its eagerly anticipated decision on the scope of the liquidator's equitable lien in *Stewart v Atco Controls Pty Ltd (In Liquidation)* [2014] HCA 15.

The seminal case in this area is *Re Universal Distributing Co Ltd (In Liq)* (1933) 48 CLR 171, where Dixon J concluded that a secured creditor may not have the benefit of a fund created by a liquidator's efforts in the winding up, without the liquidator's costs and expenses of creating that fund being first met. To that end, equity would create a charge over the fund in priority to that of the secured creditor.

#### BACKGROUND

The respondent (**Atco**), was the secured creditor of Newtronics Pty Ltd (In Liq) (Receivers and Managers Appointed) (**Company**). The Company's liquidator James Henry Stewart issued proceedings claiming that Atco's charge was invalid and the receivers' appointment was void. These proceedings were funded by an unsecured creditor of the Company, Seeley International Pty Ltd (**Seeley**).

The receivers settled with and paid the Company \$1.25 million (**settlement sum**). The Company paid that money to Seeley under the terms of the funding arrangements. Atco later established that its charge was valid and demanded repayment of the settlement sum pursuant to its charge. The Company declined on the basis that the Liquidator was entitled to an equitable lien over the settlement sum in respect of the costs and expenses incurred in recovering that money and had paid it to Seeley pursuant to the terms of their indemnity. The quantum of the liquidator's costs and expenses is still to be assessed.

Before the Victorian Court of Appeal, Atco had established that particular features of this case precluded the *Universal Distributing* principle from applying (or applying directly or without qualification) to give the Liquidator an equitable lien over the settlement sum in priority to Atco. These included the fact that the Liquidator's costs and expenses had already been paid under an indemnity from Seeley and that in the circumstances it was unconscionable for Seeley to receive the money.

#### THE HIGH COURT'S FINDINGS

In a joint judgment by Crennan, Kiefel, Bell, Gageler and Keane JJ, the High Court concluded that there was no basis for excepting this case from the application of the *Universal Distributing* principle. Notably, it held that the purpose of the litigation commenced by the Liquidator was the realisation of assets, just as it was in *Universal Distributing*.

In reaching its conclusion, the High Court considered and more or less dismissed the various factors identified by the Court of Appeal as distinguishing this case from one to which the principle applies.

We have identified the following important take-home points arising from the judgment:

- *Universal Distributing* does not stand for the principle that a secured creditor has to have willingly participated in the realisation of assets in order for their security to be postponed to the liquidator's equitable lien. The secured creditor "comes in" to a winding up simply by seeking the benefit of a fund created by the liquidator in the winding up.
- When determining whether the liquidator's work done was for the "exclusive purpose of raising the fund" (as per Dixon J in *Universal Distributing*), the subjective purpose of the liquidator in bringing litigation is not the relevant consideration. The proper question to ask is if the costs and expenses claimed could be said to have been incurred in realisation of the asset which created the fund, which is a matter to be determined by the liquidator's verification of his accounts.
- A secured creditor does not have to request litigation be brought by the liquidator for the liquidator's lien arising from work in conducting that litigation to operate.
- Just because the liquidator has been indemnified for his or her costs by another party, such as an unsecured creditor, does not preclude the existence of an equitable lien. Further, any agreement between liquidator and another party funding the litigation cannot be relied upon by the secured creditor as precluding the equitable lien. The High Court recognised in the current case that the indemnifier had a right of subrogation and the liquidator was obligated to reimburse the indemnifier out of any recovered funds.
- There is nothing unusual about an unsecured creditor providing an indemnity to a liquidator to enable an action to be brought against, amongst others, a secured creditor.
- It is not part of the liquidator's duty to ensure that litigation conducted in the course of the realisation of assets is for the benefit of a secured creditor, or any particular creditor. Conversely, it is part of the liquidator's duties to carefully scrutinise charges existing over company property and in certain circumstances, attack them and have them declared void.
- The liquidator's duty is owed to the body of creditors as a whole and to the court and is to do what he or she can to enlarge the disposable assets of the company.
- The liquidator must however exercise care in determining whether to commence litigation and act with propriety in doing so. In the current case, the High Court concluded that the liquidator had received advice from Counsel and there was no suggestion that he had been reckless in bringing the actions or that the actions had no prospects of success.
- A liquidator can seek funding outside section 564 of the Corporations Act by way of an indemnity for their costs and expenses which does not require the court approval when the recovery is restricted to the amount of the liquidator's costs and expenses recovered.

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