

## Article Information

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## Featherweight securities to mitigate administration risk

**When a borrowing company goes into administration, lenders will want to enforce their security immediately. However, administration risk delays lenders from enforcing their security during the moratorium period without leave from the court or consent from the administrator.**

**This article provides an insight into administration risk, explains ways to mitigate administration risk and how featherweight securities can be effectively used.**

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When a grantor becomes insolvent, a secured creditor may be able to claim their rights in the secured assets through external administration. In order to enforce security interests, lenders must ensure that the interest is perfected. When a borrower goes into administration, lenders are only able to enforce their security in limited circumstances during the moratorium period. The moratorium period occurs throughout the duration of the administration and temporarily prevents court or enforcement proceedings against the company or its property. This gives rise to administration risk.

### Understanding Administration Risk

Administration risk arises from section 440B of the *Corporations Act 2001* (Cth) (**Corporations Act**) which provides that during the administration of a company, the holder of the security interest over that company is unable to enforce the security interest during the moratorium period without:

1. the leave of the court;
2. the consent of the administrator; or
3. holding security over all or substantially all of the assets of the grantor of that security.

The moratorium period comes into effect when an administrator is appointed and lasts the duration of the administration which is generally six to eight weeks, depending on the size and complexity of the company. During this period, a moratorium is imposed on secured and unsecured creditors enforcing rights against the insolvent company. The intention of the moratorium period is to provide the company with 'breathing space' which gives stakeholders time to consider their next steps.

The moratorium prevents (among other things):

1. proceedings being commenced seeking that the company be wound up;
2. lenders from enforcing their security interest (subject to the matters set out below);
3. legal proceedings being commenced or continued against the insolvent company and any enforcement action in relation to proceedings already; and
4. creditors from enforcing rights under guarantees.

### Mitigating Administration Risk

#### **Section 441A of the Corporations Act**

Section 441A of the *Corporations Act* provides an exception to the statutory moratorium on the enforcement of certain rights of secured creditors holding a security interest which is perfected under the *Personal Property Securities Act 2009* (Cth) (**PPSA**). This exception states that a secured creditor may enforce their security interest if:

1. the creditor has a perfected security interest over the whole, or substantially the whole, of the property; and
2. the enforcement occurs within the decision period, being 13 days after the appointment of the administrator.<sup>[1]</sup>

Whilst the PPSA does not govern security over real property (i.e. land), it is important that as a lender, any general security deed or agreement entered into, also includes a charging clause over all of the borrower's present and after-acquired (i.e. future) property. This will assist a lender to be in a position to immediately enforce its security during the decision period and mitigate the administration risk.

In *Re Australian Property Custodian Holdings Ltd (admins apptd) (recs & mgers apptd)*<sup>[2]</sup> the Court confirmed that "the whole, or substantially the whole, of a company's property" means more than just a "significant part" of the company's property. In this case, it was held that a charge covering 68% of the company's assets did not represent the whole or substantially the whole of the company's property and therefore the section 441A exception could not be relied upon. When determining whether a lender has a security interest over the "whole, or substantially the whole" of the property of the company under administration, the court will generally measure the property over which the security interest was held in proportion to the whole of the company's property in terms of relative value.<sup>[3]</sup> However, it is important to note that there is still uncertainty as to what constitutes "the whole, or substantially the whole, of a company's property", and it will be considered on a case by case basis. Accordingly, it is important as a lender to ensure that you have security over all of a company's assets to avoid ambiguity when it comes to the section 441A exception.

### **Featherweight Securities**

In instances where a lender is unable to take a security interest over all of the assets of the company, they may seek to take a featherweight security interest. This security structure involves the specific security to be taken over one or some of the assets of the company under a specific security agreement. A featherweight security is then taken over the remaining assets of the company. A featherweight security is a charge that does not attach to any property unless there is an event of default, which will invariably include an insolvency event such as the appointment of an administrator. It does not prevent the borrower from freely dealing with the property the subject of the security in the ordinary course of business. A featherweight security will rank behind the other security interests granted by the borrower over the secured property. Traditionally, there is a nominal monetary limit on the amount a lender can recover from enforcing the featherweight security, as the featherweight security is used solely as a tool for enforcement.

As an example, ABC Finance Pty Ltd (**ABC Finance**) lends \$150,000 to Smith Motors Pty Ltd (**Smith Motors**) to fund the purchase of two mining trucks. Smith Motors is a car dealership and owns other motor vehicles including motorbikes, cars and trucks which are not subject to any registered security interests. ABC Finance only takes security over the two mining trucks and no other assets belonging to Smith Motors. If Smith Motors goes into administration, ABC Finance is unable to enforce its security against the borrower during the moratorium period unless leave is granted by the court or consent is given by the administrator. However, if ABC Finance had also taken a featherweight security, that security would affix to Smith Motors' other assets at the event of default. In that scenario, ABC Finance would, in all likelihood, have a security interest over the "whole or substantially the whole" of Smith Motors' property. ABC Finance would be able to rely on the section 441A exception, which allows ABC Finance to enforce its security interest within 13 days of the appointment of the administrator without seeking the leave of the court or consent. Therefore, featherweight securities can be used as a tool to mitigate administration risk.

There are generally limitations to a featherweight charge including that the borrower could be in breach of any negative pledge covenants they may have to other lenders. However, given that featherweight securities are widely accepted in the market, this is unlikely to be an issue for any subsequent lender.

### **Key Takeaways**

- When a corporate borrower enters into administration, secured lenders are only able to enforce security interests during the moratorium period with the leave of the court or with consent of the administrator subject to the below;
- If a creditor has a security interest over the whole, or substantially the whole, of the property of a grantor, then the creditor may enforce during the decision period, being 13 days after the appointment of the administrator;
- The moratorium period is triggered when an administrator is appointed and lasts the duration of the administration. During the moratorium period, lenders are prevented from enforcing their security interest and no legal proceedings may be brought against the borrower; and
- To attempt to mitigate administration risk, lenders may consider taking a featherweight security interest, which is a floating charge that is taken over all the other assets of the company and becomes enforceable only when an administrator is appointed. It is used purely as a tool to mitigate administration risk.

*For further information relating to administration risk and featherweight securities, please contact Banking and Finance Partner, Greg Conomos and Restructuring and Insolvency Partner, Angelina Kozary.*

[1] *Corporations Act 2001* (Cth) s 441A.

[2] [2010] VSC 492 [8] (Justice Sifris).

[3] *Ibid*; *Photios v Cussen and Senatore (in Their Capacity as Joint Administrators of Beechworth Land Estates Pty Ltd (Admini Apptd))* [2015] NSWSC 336 [83].