# COMMENTARY ON PROJECT SECURITIES


## By B. R. Johnston*


John Lehane is to be congratulated on his comprehensive and thought provoking paper. It covers a wide territory with areas of extreme complexity and in some cases where answers are not yet available. The task of finding solutions will be as daunting to the project lender as it will be gratifying to the lawyers.

Time will only enable me to touch briefly on some of the topics raised by Lehane.

## 1. FLOATING CHARGES

The principal disadvantages of a floating charge have been clearly identified by Lehane. Expressed in other words, those disadvantages (other than non-recognition in some jurisdictions) are really nothing more than illustrations of the priority principles governing floating charges. Thus, unsecured creditors (other than preferred creditors) who are paid out before crystallization, execution creditors who complete execution before crystallization and bona fide purchasers in the ordinary course of business until crystallization (unless the transaction can be set aside as an undue preference under section 451 of the Companies Code), will all rank ahead of the floating charge. In addition, the floating charge will be postponed to a subsequent non-registrable legal interest unless there is notice of the restriction of the company's right to create other charges and postponed to subsequent registered fixed charges unless pursuant to section 204(3) of the Companies Code the floating charge contains a restriction against subsequent fixed charges and the notice draws attention to this fact. Finally, it should be noted that the Companies Code expressly subjects floating charges to two further imperfections. First, section 446 postpones floating charges to certain preferential creditors on liquidation. Secondly, section 452 provides, *inter alia*, that a floating charge created within six months of winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except to the amount of any monies paid to the company at the time of or subsequently to the creation of, and in consideration for the charge. The last section will affect, in particular, security to secure past indebtedness or for monies which do not go to swell the assets of the company and become available to creditors generally or to secure third party indebtedness.[1] Protection against these sections will not be available by provision in the security for automatic crystallization.[2]

In the absence of an automatic crystallization clause, it appears to be well settled law that crystallization will not occur until the company goes into liquidation, stops trading, disposes of the whole of its undertaking or trading assets with a view to cessation of trading or a creditor takes positive action to cancel publicly the company's implied licence to continue to deal with its assets in the ordinary course of its business by appointment of a receiver or otherwise.


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1 *Cosmas Fish Processors International Pty. Ltd. & Anor. v. M. Hoffman Nominees Pty. Ltd. of Aust.* (1982) 1 A.C.L.C. 52.

2 Companies Code, sub-s. 5(1) (definition of 'floating charge').

Assuming the legitimacy of automatic crystallization clauses,[3] the draftsman will need to use clear and unambiguous language to clearly provide that the floating charge will immediately attach and become fixed upon the happening of defined events of default. Traditional provisions may not be sufficient and any uncertainty may be fatal.[4]

## 2. SALES CONTRACTS AND PROCEEDS

The law governing the assignment of intangible movables, particularly when one comes to the conflicts of laws rules, is a minefield for the uninitiated. Some of the points raised by Lehane are worth developing.

As stated, not every contract is assignable. Much depends on the type of contract and/or its terms and conditions. For example, if the contract involves some display of personal skill or its performance depends on some personal qualities or capacities, the contract cannot be assigned. The question of whether a particular contract calls for such personal performance as to preclude assignment, is one of law, to be decided on the construction of the contract, as applied to the subject matter and the circumstances of the parties. Among the considerations, to which weight is given in the determination of the matter are the following: (i) the extent to which rights under the contract would be altered by an assignment, (ii) how material or immaterial it is for the party on whom the obligation lies that he should be able to continue to discharge this obligation to the other party only, (iii) whether the skill, experience, judgment of the purported assignor formed a material part of the consideration for the contract, (iv) the non-pecuniary character of the contractual right sought to be assigned, and (v) the credit worthiness and good faith of the purported assignor.[5]

In most cases, the point would not be in issue in the case of a resources sales contract unless one can say with certainty that it would be a matter of indifference to the buyer as to who performs the contract.

Once again, if the contract contains an express condition that it is not to be assignable then in many instances (but not all) this will be effective to make the contract unassignable. Whilst the contract may not be assignable because of these features this conclusion may not necessarily prevent assignment of the income stream.[6]

However, in many instances, as a practical matter, the project lender will not wish to rely solely on learned counsel's opinion or take security without the involvement or concurrence of the debtor. As pointed out by Lehane, the project lender will not want to run the risk that the assignment is ineffective or results in a breach of the contract entitling the debtor to terminate the same. In addition, good and sufficient security will depend on the contract running its full term and the financial benefit thereunder being wholly received. Thus, the project lender will wish to give consideration, at the very least, to obtaining the agreement of the debtor, (i) to provide notice of default to the project lender, (ii) to give its receiver or receiver/manager the opportunity to remedy the default and perform the obligations of the assignor before the debtor's entitlement to cancel or rescind becomes

3 Gough W.J., *Company Charges* (1978) 106.
4 *Re Bismark Australia Pty. Limited (Receivers and Managers app't'd.)* (1981) V.R. 527. See also Gough, *op. cit.* 103 and Appendix IV (Specimen Clauses for Security Contracts).
5 Starke J.G., *Assignments of Choses in Action in Australia* (1972) 65.
6 *Ibid.* 66.

effective, and (iii) in the case of a take or pay contract, not to exercise any set-offs, counter claims or other defences which might cancel or diminish the obligations as against the project lender although without prejudice to the right, after the project lender has been paid, of the debtor to pursue those claims as against the assignor. Of course, there will be many other matters which will merit separate attention such as an evaluation of the vulnerability of the contract to be assigned to production curtailments or suspensions, *force majeure*, intervening political acts, escape clauses available to the debtor and the need for trust mechanisms for collection of proceeds, allocations between the project lender(s) and the borrower, the regime for the temporary investment of funds pending distribution and so on.[7]

To be realistic, lenders should view an assignment of proceeds as basically a secured collection mechanism subject to interruption by circumstances beyond their control.[8]

When assignment is not possible, the project lender will need to resort to other techniques as discussed by Frank Conroy in his commentary.

In Australia, notification to the debtor will be desirable for a number of reasons, namely (i) in the absence of notice, the debtor is sufficiently discharged if payment is made to the assignor, (ii) priority depends on the date of notice to the debtor and in the event of there being more than one assignment, priority goes to the assignee who gives first notice, and (iii) an assignee takes subject to equities available to the debtor as against the assignor (*i.e.* set off), but only up to the date of notice. In addition, it will be desirable to give the notice in the manner provided by the Australian statutory provisions (such as section 20 of the Property Law Act 1969 of Western Australia) so as to enable the project lender to sue in its own name (thereby overcoming the necessity of joining the assignor to proceedings for recovery) and empowering it to give a good discharge without the assignor's concurrence, while disposing of any requirement for proof of consideration.

Turning now to the conflicts of laws rules, only one thing is certain. Because of the lack of uniformity in case law and amongst the writers, the project lender will be compelled to ensure that the assignment complies with each and every system of law which impinges on the transaction, however remotely.

## 3. INFRASTRUCTURE AGREEMENT AND ASPECTS OF LIMITED RECOURSE

When project lenders are asked to look at the borrower's interest in a project as their sole or principle source of repayment, the nature of those assets is an important factor. In particular, the provisions of infrastructure or state agreements will need to be very carefully considered.

I need not dwell on the topic of infrastructure or state agreements as this has been exhaustively covered in Leigh Warnick's excellent paper. It is sufficient to note that if an assignment is made of the rights of a joint venturer under a Western Australian state agreement, then the assignee must also take an assignment of the obligations of the joint venturer unless (arguably) the assignment is by way of security.

Lenders will almost always wish to put themselves in a position where they can cut their losses and realize the borrower's interest. Aspects of security and/or

7 For a detailed discussion of these aspects see Rendell R.S. (ed.), *International Finance Law — Lending, Capital Transfers and Institutions* (1980) 47A.
8 *Ibid.*

enforcement which involve an assumption or effective acceptance of unlimited liability to contribute to the costs of the project may be unattractive to lenders. This risk may be compounded by the credit risks of other co-venturers taking into account any joint and several liability.

Solutions to these problems may require handling as described by Conroy in his commentary or by adoption of techniques involving the 'special share' device (giving the lender in appropriate circumstances power to control the board), share mortgages (to enable control of the joint venturer on default) and/or sponsor takeout for an amount being the lesser of the loan amount or market value of the joint venturers' interest.[9]

Finally, the points raised by Lehane on aspects of limited recourse are vital to borrowers if they have any desire to have a limited recourse loan.

## 4. STAMP DUTIES

Whilst the new Companies Code dispenses largely with the necessity to consider multiple registrations[10] the problems surrounding stamp duties remain. It is worth noting that the Eggleston Committee observed 'implementation of our proposals for a single State or Territory of registration will involve a reconsideration either of the basis on which stamp duty is assessed or of the system of collection'. Unfortunately, this has not been achieved. Thus, the new system still requires consideration being given to the stamp duty liability in other jurisdictions, in particular, the availability of exemptions, the scope for reductions having regard to value of property in and outside jurisdictions or duty paid elsewhere,[11] the need for limited collateral securities and the possibilities for structuring the transaction so as to minimize duty by the elimination of nexus of other means.

One of the very great difficulties in this process is that stamp duty treatments including interpretations and/or practices of respective authorities differ (and in some cases, markedly) from one jurisdiction to another. It would not be possible within the time allocated to this commentary to cover the subject. However, let me illustrate some of the stamp duty problems that confront lenders and their borrowers in Western Australia, attendant on a charge requiring registration in Western Australia or having a sufficient nexus with Western Australia.

As with the Tasmanian Act, the Western Australian Act contains no provision for exemption of foreign securities or for reduction of duty having regard to the value of property secured in and outside Western Australia or duty paid elsewhere.

Thus, on the face of it, in so far as it is necessary for a charge to be registered with the Western Australian Corporate Affairs Commission, then notwithstanding that the monies are secured wholly on property outside Western Australia, that in

9 Ladbury R.A., Fox P. and Nettle G.A.A., 'Current Legal Problems in Project Financing' (1981) 3 *A.M.P.L.J.* 139.

10 *Luckins v. Highway Motel (Carnarvon) Pty. Ltd.* (1976) 7 A.L.R. 413. The Northern Territory is not a participant in the new Companies Code scheme. It is not subject to the 'home' jurisdiction principle so that a charge created by a company incorporated in the Northern Territory may require registration in each other State and Territory. Charges operating with respect to property in the Northern Territory will require separate registration there.

11 Stamps Act 1958 (Vic.), s. 137DA; Stamp Duties Act, 1920 (N.S.W.), s. 84F; The Stamp Act, 1894 (Qld.), First Schedule, para. 4; Stamp Duties Act, 1923–1981 (S.A.), s. 81b; Stamp Duty Ordinance 1978 (N.T.), sub-s. 6(11).

terms of the instrument no matter or thing is to be done in Western Australia and that duty may have been paid elsewhere, the instrument would be liable to full Western Australian *ad valorem* duty on the total amount secured. In addition, subject to the comments below, a charge not requiring registration in Western Australia which relates to property situate in Western Australia (however low the value may be) or any matter or thing done or to be done in Western Australia would be liable to full *ad valorem* duty on the total amount secured. In the latter situation, however, the policy of the Western Australian authority is to levy stamp duty only to the proportion that the value of Western Australian property bears to the total value of property in and outside the State.

Whether or not liability can be avoided by executing and leaving outside the State instruments that would otherwise be subject to duty, is a moot point.

As with Victoria, Queensland and South Australia, the Western Australian Act contains specific provision relating to instruments executed and held outside the State. Sub-section 16(3) of the Western Australian Act provides that where any instrument which relates to property situate in Western Australia or to a matter or thing done or to be done in Western Australia is either executed in Western Australia or outside the State and is held outside the State the provisions of the Act apply to it as if the instrument were executed and held in Western Australia.[12]

However, unlike the equivalent provisions in Victoria and South Australia, section 20 of the Western Australian Act continues to provide that an instrument executed outside Western Australia may be stamped without penalty within a period of one calendar month after the instrument is first received in Western Australia. As a result it may be possible to argue that whilst sub-section 16(3) makes the Western Australian Act applicable to instruments executed outside Western Australia, it does not override section 20 which expressly governs the time within which instruments executed outside Western Australia may be stamped without liability. In addition, if the position were otherwise it would be extremely difficult to think of a situation where section 20 would continue to apply. However, sub-section 16(3) was clearly intended to overcome the avoidance practice of executing and leaving outside the State, documents that would otherwise be subject to duty. In the event of interpretation going against the Commissioner, the risk must always be present that the State may retrospectively legislate to achieve its stated objective.

Finally, it should be noted that section 31A of the Western Australian Act provides, *inter alia*, where any person fails or neglects to lodge with the Commissioner any document for stamping or the Commissioner has reason to believe or suspect that any person is liable to pay any duty, the Commissioner may create a memorandum of the document and cause an assessment to be made of the amount which, in his judgment, ought to be levied and that person shall be liable to pay that amount. Written notice of the assessment and the amount to be paid is to be served on the person liable to pay it. The amount so specified is payable on or before the date specified in the notice (being a date not less than one month after the date of service of the notice). The memorandum so created is deemed to be an instrument for the purposes of the Act.

12 What will constitute a sufficient nexus to attract duty upon execution outside the jurisdiction was considered in *Ansett Transport Industries (Operations) Pty. Ltd. v. Comptroller of Stamps (Vic.)* (1982) 80 A.T.C. 4323.

## 5. PRIORITIES

The most major innovation of the new Companies Code in relation to charges is the introduction of a system of priorities depending upon time and date of lodgement of charges. Put simply, the order of priorities is as follows:

(i) A registered charge has priority over a subsequent registered charge unless there was notice (actual or constructive) of the subsequent charge at the time of creation of the prior registered charge.

(ii) As between unregistered charges priority is determined according to dates of creation.

(iii) As between non-registrable charges and unregistered charges, priorities will be determined according to principles of law.

(iv) As to priority between amounts secured by competing charges, a registered charge has priority over a subsequent registered charge for the maximum amount specified in the Form 47 Notice lodged with the charge, or, if no maximum amount is so specified, for all liabilities (present and future) if the holder of the first charge does not have 'actual knowledge' of the subsequent charge. If the holder of the first charge does have 'actual knowledge' of the subsequent charge and he has not specified a maximum amount in the Form 47 Notice, he will have priority for present liabilities at the time he first obtained 'actual knowledge' of the subsequent charge and also for further advances made after that knowledge if the terms of his charge required him to make those advances.

(v) The system of priorities is subject to consents, waivers and priority agreements and priorities conferred by other registers.

It is worth noting that priority gained by registration depends upon not having 'notice'. Notice includes constructive notice except in cases where actual notice is required. Constructive notice has the same meaning at general law since by definition constructive notice of the relevant interest refers to an unregistered interest.[13]

Incorporation of the doctrine of constructive notice raises difficult questions as to whether the registration system constitutes notice of a charge and its contents to persons dealing with the company. Whilst there does not appear to be any Australian authority on the point, there have been English and New Zealand decisions[14] to the effect that registration constitutes constructive notice of the existence of a charge but not of the contents of the document creating it, such as restrictions against subsequent charges or dealings. Thus, prior to the Companies Code, the practice was adopted of including a summary of the restrictions on the creation of other charges or other dealings in the Statement of Particulars to be lodged with the charge, in an endeavour to constitute such notice. The efficacy of this practice was questionable on the ground that constructive notice could not extend (arguably) to matters beyond those which were required to be inserted in the registered particulars. However, under the new Companies Code it is now possible to notify the restriction in the Form 47 Notice. In addition, there appears to be no reason why the notification could not include notification of an automatic crystallization provision if incorporated in the charging clause.[15] But, whether this

13 Gough W.J. *Company Charges: An Australian Supplement* (1983) 49.
14 Gough, *Company Charges* 355 ff. and the authorities there cited.
15 Gough, *Company Charges: An Australian Supplement* 3.

overcomes the problem of constructive notice is not clear. Arguably, it does not on the basis, *inter alia*, (i) that the Commissioner of Corporate Affairs is not required to record the restriction in the Register of Charges[16] and thus 'the public should not be deemed by law to know of something which the statute does not specifically require to be disclosed on the Register itself' and (ii) that as the Companies Code does not regulate priority of non-registrable charges, a subsequent non-registrable charge holder 'should accordingly not be concerned to enquire at the charges register'.[17]

If this is correct, the result would be that the pre-Code situation concerning constructive notice as discussed above would continue unchanged. The solution may be to require (where sufficiently important) that the company amend its Articles (being a document to which the doctrine of constructive notice has been held to apply) so as to provide that after the giving of a floating charge the company would be unable to create charges ranking ahead of it without the consent of the holder of the floating charge.[18]

As pointed out by Lehane, the meaning of sub-section 204(4) of the new Companies Code could be so interpreted that the sub-section does not apply to a floating charge to which sub-section 200(1)(a) of the new Companies Code applies on the basis that as it covers the field there would be 'no other property' to which the sub-section applies. Dealing with this, Gough states:

> It is submitted that this view is not correct. Sub-section 204(4) expresses itself in relation to registrable charge property, whereas a floating charge is registrable according to the nature of the charge, regardless of the kind of property subject thereto. Moreover, it would have been simple enough for the sub-section expressly to exclude the case of the floating charge, if such had been the legislative intention.[19]

The distinction between a present liability and a prospective liability is not one to which the definition necessarily provides clarification. In industrial parlance, the definitions provide fertile ground for demarcation disputes. One approach may be to draw the boundary lines as suggested by Gough:

> These terms are not entirely free from doubt, but it is submitted that sense can be readily given to them by following the common law distinction between present or immediate debts and contingent debts. A debt may be presently or immediately due, but payable now or in the future (in the latter case 'debitum in praesenti solvendum in futuro'). As distinct from a present debt, a contingent debt is not immediately due, in the sense that a debt has not yet matured or accrued, or become fixed or definite in the way of becoming a binding obligation. The putative debtor may never become presently liable. The dichotomy in the Code fits neatly into this previous distinction. Prospective liability, too, probably refers also to a 'future present liability', *i.e.* a debt not yet incurred but which may be contemplated, although there is nothing existing in the nature of a contingent liability. In other words, the dichotomy can simply refer to, for example, present and future advances. This, it is submitted, best explains the statutory choice of language: prospective liability means any liability that may arise in the future (*i.e.* future indebtedness), or any other liability (*i.e.* contingent indebtedness).[20]

Testing this against Lehane's examples, the result would appear to be (i) that interest under a floating rate loan would be a prospective liability because it is not

16 Companies Code, sub-s(s). 203(2) and 203(8).
17 Gough, *Company Charges: An Australian Supplement* 47.
18 Ford H.A.J., *Principles of Company Law* (3rd ed. 1982) 270–272.
19 Gough, *Company Charges: An Australian Supplement* 2, n. 17.
20 *Ibid.* 30–31.

capable of being ascertained, with the result that different priorities could apply between principal and interest, and (ii) that liability in respect of outstanding guarantees or letters of credit under a letter of credit/guarantees facility would be a prospective liability because liability will not arise or become fixed or definite until the occurrence or an event of default.

Whilst any interpretive difficulty can be resolved by setting out in the Form 47 Notice a short description of the liability (whether present or prospective) and the maximum amount secured, this may create a stamp duty problem unless the stamp authority can be persuaded that the nominated amount to which the instrument is to be stamped and the maximum amount to which the instrument is to have priority are not so intimately related that the two amounts cannot be divorced, for stamp duty purposes.[21]

There are further difficulties. As stated, the meaning of paragraph 4(a) of Schedule 5 of the new Companies Code, is not entirely free from doubt. In particular, the word 'advance' is ambiguous and susceptible of a number of meanings. The cases show that different meanings have been attached to the word in a variety of contexts and circumstances.[22] Whether the word is to have a narrow or wide meaning or whether the matter can be determined on the true construction of the charge is not clear.

Finally, let me conclude by expressing the hope that these interpretative difficulties will be soon removed by appropriate amendment. The game is difficult enough to play without the basic ground rules being capable of different interpretation.

21 In Western Australia, the Commissioner has accepted (after some debate *and* after, it is believed, Crown Law Department advice) that a statement of maximum prospective liability for which priority is claimed, is not to be taken as a limitation on the amount to be secured for stamp duty purposes.
A clause which may be used in an unlimited security to achieve this situation is:
In accordance with the provisions of paragraph 3 of Schedule 5 to the Code and for the purpose of fixing priorities between this Charge and any subsequent charge which is registered under the Code and for no other purpose whatsoever the Lender and the Borrower agree that the maximum prospective liability secured by this Charge is [ ] dollars ($ ) and notwithstanding any rule of law or equity to the contrary nothing in this Clause shall prejudice or affect the obligations of the Borrower under this Charge.

22 *Re Data Technology Pty. Ltd. (In Liq.)* (1976) 2 A.C.L.R. 120.