

## Securities lending contracts are not mortgages or charges

The purpose of this note is to summarise the decision of Justice Finkelstein in *Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Limited* [2008] FCA 594 (handed down on 2 May 2008).

Justice Finkelstein has ruled that the securities lending contract between Opes Prime and its clients did not have the effect of conferring any equity of redemption or other equitable estate or equitable interest, including a charge, in the securities or equivalent securities. Instead, the contract passed unencumbered title in the securities on delivery of the securities.

### Background

Beconwood entered into a securities lending arrangement with Opes Prime. It used a contract based on the AMSLA (the Australian Masters Securities Lending Agreement).

Under the contract, Beconwood supplied a parcel of securities to Opes Prime, in return for a payment of money. In accordance with the AMSLA-type provision, Opes Prime undertook to supply Beconwood with equivalent securities when Beconwood repaid the "loan".

Opes Prime then supplied Beconwood's securities to ANZ, under a separate securities lending arrangement.

Opes Prime collapsed and a receiver and a voluntary administrator were appointed. Beconwood wanted to regain possession of its securities. However, title to the securities had by now passed to ANZ and to its internal ANZ custodian and nominee. Beconwood may have had a claim for damages against Opes Prime, but Opes Prime's apparent

insolvency meant that any amount that might be recovered would probably be less than the value of the securities. Beconwood began legal proceedings to recover the securities from ANZ.

As a preliminary issue, Justice Finkelstein decided to issue a ruling on the legal effect of the securities lending agreement.

### Beconwood's argument

The securities lending agreement stated that "all right title and interest in" the securities passed from Beconwood to Opes Prime.

Notwithstanding this, Beconwood claimed that the agreement was, in reality, a legal mortgage pursuant to which it borrowed money from Opes Prime and provided its shares as security. Under a legal mortgage, property in the security passes to the lender, but the borrower retains an equity of redemption (ie. the right to regain title to the security upon repayment of the loan). Beconwood argued that, even after transfer to Opes Prime and then to ANZ, the securities were subject to the equity of redemption. This would mean that Beconwood would be entitled to have the securities returned to it by ANZ.

Alternatively, Beconwood argued that the securities lending agreement had created a charge in its favour. In brief, the argument was that, as a result of an implied term in the agreement, the securities were charged in Beconwood's favour as soon as they were transferred to Opes Prime by Beconwood:

"The way the argument proceeds is as follows. Upon delivery to it of the lent securities, title passes to OPS. At that point the securities,

because they are identical in number and type to the lent securities (Securities), immediately fall within the definition (and thus assume the character) of Equivalent Securities which, in due course, must be delivered to Beconwood. The crux of the argument is that under the SLA OPS has an implied obligation to hold or retain an interest in any securities that meet the definition of Equivalent Securities as soon as it receives or obtains such securities. In those circumstances, Beconwood contends that it has a charge, or some kind of equitable interest, over the securities until it obtains legal title on the transfer back."

In the face of evidence by ASLA (the Australian Securities Lending Association) that the legal effect of an AMSLA-type agreement is to transfer unencumbered title to the securities borrower, Beconwood argued that the agreement should be given a different interpretation when it was used by retail investors.

A subsidiary issue was whether netting provisions in the securities lending agreement had been automatically triggered by the appointment of a receiver and a voluntary administrator to Opes Prime.

### What the Court said

#### *No mortgage*

Justice Finkelstein held that the securities lending agreement was an outright transfer of property, rather than a mortgage, for a number of reasons:

- it expressly said that it transferred unencumbered title in lent securities;

- there was no provision requiring the securities borrower to return in specie the securities that were originally lent;
- there were netting and set off provisions that came into effect on default, which converted redelivery obligations into payment obligations (confirming that the parties to the agreement did not intend there to be any equitable property rights over lent securities).

#### *No charge*

Beconwood's claim that the securities were subject to a charge was also dismissed:

- Justice Finkelstein said that there were no obvious grounds for reading the suggested implied term into the securities lending agreement. He said that implying such a term into the agreement would convert it into a mortgage or a charge, which it was not;
- the agreement had no provision restricting Opes Prime from disposing of Beconwood's securities or requiring Opes Prime to keep equivalent securities on hand at all times. On the contrary, the agreement contemplated that the lender could meet its obligations to provide equivalent securities from its own holdings or in the open market.

#### *No event of default*

As a subsidiary point, Justice Finkelstein looked at whether the agreement's netting provisions had been automatically triggered by the appointment of receivers and voluntary administrators to Opes Prime. The agreement provided that the netting provisions were automatically triggered by "the appointment of a liquidator or analogous officer". The question for Justice Finkelstein was whether the appointment of receivers or voluntary administrators was analogous to the appointment of a liquidator.

He decided that the netting provisions had not been automatically triggered:

"In my view the role and function of, on the one hand, a party-appointed receiver or an administrator and, on the other hand, a liquidator, are not analogous. The role of

a liquidator is to get in the assets of the company that is being wound up, dispose of those assets and out of the proceeds discharge the debts due to creditors (pro rata if there is a deficiency) and pay the balance (if there be a balance) to the contributories. When this task is complete the company is finished. This is in marked contrast to the role of a party-appointed receiver or an administrator. A party-appointed receiver takes control of the company's assets (and sometimes manages its business), but for the single purpose of discharging the debt due to his appointer, the secured creditor. The receiver holds any surplus he has secured for the benefit of the company. On his retirement the company continues in existence. An administrator does little more than take over the running of the company, and then only for a relatively short period. This enables the creditors to decide the company's fate."

#### *No different conclusion for retail investors*

Justice Finkelstein also dismissed Beconwood's argument that the legal effect of the securities lending agreement should depend upon whether it was being used by institutions or by retail investors:

"First of all, I disagree with one fundamental premise of this argument, namely that the transactions which are given effect by the SLA and other securities lending agreements take place in different markets. The view I take is that as each agreement may be used for financing purposes they are made in the same market, namely the market for providing funding to intending share purchasers. In any event, even if they be different markets, that would not, in my view, be good reason for giving a different meaning to the same agreement. This is because I do not accept that a share lending agreement (indeed any agreement) can have a meaning that is dependent upon (and changes with) the subjective motivations for which it is entered into.

What Beconwood's argument comes down to is this. Being an unsophisticated investor, it did not know what it was getting into when it signed the SLA and its lack of sophistication

is a sufficient reason to give the SLA a construction it would not bear if entered into by skilled market players such as investment banks, hedge funds or arbitrageurs. I do not accept this argument either. Beconwood borrows for, and invests millions of dollars in, share trading. It does not qualify as an unsophisticated investor. It certainly is not a candidate for the special protection courts give to the weak and vulnerable. "

#### **Where to from here?**

Media reports indicate that Beconwood may be considering an appeal from Justice Finkelstein's decision. Regardless of whether there is an appeal, this decision is by no means the end of litigation surrounding Opes Prime's securities lending agreement.

The question of the effect of the agreement may arise in other cases in other courts (although it should be noted that, in a decision earlier this week, the NSW Court of Appeal appears to be of the same view as Justice Finkelstein).

In addition, Opes Prime clients have foreshadowed claims based upon their individual dealings with Opes Prime, focusing on representations allegedly made to them by Opes Prime. These claims would not affect Justice Finkelstein's findings on the inherent legal effect of the securities lending agreement, but might result in an award of monetary damages to a client.



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