



Australian Government

Corporations and Markets
Advisory Committee

Rehabilitating large and complex enterprises in financial difficulties

Discussion Paper
2003

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complex enterprises in
financial difficulties

Discussion Paper

September 2003

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ISBN 0-9751352-0-1 (print version)

ISBN 0-9751352-1-X (on-line version)

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Introduction

Role of corporate rehabilitation

0.1 Giving enterprises that are in serious financial difficulties a realistic opportunity to resolve their problems and continue in business rather than go into liquidation may benefit creditors, suppliers, employees, customers, shareholders and the economy generally. Both the financial stress problems and the potential benefits of rehabilitation can be magnified for large and complex enterprises.

0.2 Corporate rehabilitation procedures should not be expected to restore all financially distressed companies as going concerns. It may be preferable to wind up enterprises that are irreversibly insolvent or whose principal activities are no longer economically efficient or viable, rather than subject them to rehabilitation attempts that merely postpone the inevitable outcome while dissipating any remaining assets of the company.¹ Also, any rehabilitation process should assist companies in serious financial difficulties, not companies that simply want a debt holiday.

0.3 This Paper examines various procedures in Australia and overseas that seek to assist the process of corporate recovery. An alternative role of some of these procedures is to provide for a more orderly liquidation, including the sale of the company's business or assets, where corporate rehabilitation is not possible. This Paper does not review the merits of alternative methods of liquidation.

Background to this review

Harmer Report

0.4 The voluntary administration (VA) provisions, which now constitute the principal corporate rehabilitation procedure in Australia, were introduced by the Corporate Law Reform Act 1992 and came into effect in June 1993. The VA procedure is based on the Australian Law Reform Commission's 1988 Report on its *General Insolvency Inquiry* (ALRC 45) (the Harmer Report).

0.5 The VA procedure was devised as an alternative to the then existing forms of voluntary insolvency administration, including schemes of arrangement, creditors' voluntary winding up and court winding up. The Harmer Report identified deficiencies in each of these forms of administration. For instance, the procedure for a scheme of

¹ For instance, as pointed out in the Productivity Commission Staff Research Paper, *Business Failure and Change: An Australian Perspective* (December 2000) at 3: 'Business failures are part of a process in which inefficient and unprofitable businesses (low returns) are replaced by efficient and profitable ones (high returns) ... The empirical evidence used by the OECD suggests that the main factor behind any increased productivity is the exit of businesses whose productivity is poor (rather than the entry of businesses whose productivity is above average)'.

arrangement involves at least two court hearings and may be cumbersome, slow and costly for many companies in financial difficulties.²

0.6 The Harmer Report anticipated that VAs would be:

- capable of swift implementation
- as uncomplicated and inexpensive as possible, and
- flexible, providing alternative forms of dealing with the financial affairs of the company.³

0.7 The Harmer Report anticipated that schemes of arrangement would be preserved for, in particular, larger private or public companies.⁴

0.8 In the decade since the introduction of VAs, larger enterprises such as Ansett and Paminco have chosen to use VAs rather than schemes of arrangement, given the ease of commencing the VA procedure and its greater flexibility in devising and settling appropriate plans for dealing with a company's financial difficulties. Nevertheless, some commentators have suggested that the VA provisions, being devised with smaller to medium companies in mind, may not be the most suitable for handling major cases.

Terms of the Advisory Committee review

0.9 The Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell, has referred the matter of rehabilitating large and complex enterprises to the Advisory Committee. In the reference, Senator Campbell noted that:

the Advisory Committee published a Report in June 1998 on corporate voluntary administration. The Advisory Committee considered that the voluntary administration procedure was generally successful and popular, and recommended a number of changes directed at fine-tuning, correcting anomalies and resolving other technical deficiencies. Since the date of that Report, the voluntary administration procedure has been utilised to administer some very large enterprises, for example Ansett and Paminco. Some commentators have suggested that this procedure is best suited to the small to medium end of the corporate spectrum and is not suitable for handling major cases.

0.10 Senator Campbell has asked the Advisory Committee to consider and report on the following questions:

- Are there particular difficulties in applying Part 5.3A to large and complex enterprises?
- If so, could the Committee recommend the most appropriate course of action to deal with those difficulties? This could include:
 - particular changes to Part 5.3A to better accommodate large corporate rehabilitation cases;

² para 46.

³ para 54.

⁴ para 57.

- particular changes to the rarely used Part 5.1 (arrangements and reconstructions) provisions to accommodate large corporate rehabilitation cases;
- a new system for corporate rehabilitation, along the lines of Chapter 11 of the United States Bankruptcy Act; or
- any other action that the Advisory Committee considers appropriate.

0.11 Senator Campbell also requested that, in considering these matters, the Committee should have regard to balancing the objectives of ensuring appropriate avenues for rehabilitation of viable businesses with the importance of preserving, so far as possible, the rights of security holders and keeping administrative cost and delay to a minimum.

Advisory Committee Voluntary Administration Report

0.12 The Advisory Committee's Report *Corporate Voluntary Administration* (June 1998) made a number of recommendations that are relevant to the rehabilitation of large and complex enterprises. Some recommendations have been included in this Discussion Paper where appropriate to the discussion of particular issues. The full text of this Report is available under *Final Reports* on the CAMAC Website www.camac.gov.au.

Advisory Committee Corporate Groups Report

0.13 The Advisory Committee's *Corporate Groups Report* (May 2000) made a number of recommendations that are relevant to the external administration of corporate groups. They are referred to in this Paper. The full text of this Report is available under *Final Reports* on the CAMAC Website www.camac.gov.au.

Structure of this Paper

0.14 This Paper examines a range of issues that apply to the rehabilitation of large and complex enterprises. Some of these matters are also relevant to other companies in rehabilitation, but may arise more frequently, create greater difficulties or be more significant for large and complex enterprises.

0.15 Chapter 1 identifies general principles for effective corporate rehabilitation procedures. In doing so, it examines and compares some key aspects of the Australian, US and UK systems.

0.16 Chapter 2 discusses a range of issues arising from the use of VA for large and complex enterprises. It examines provisions, and initiatives, in the US, UK and Canada that could be accommodated within Part 5.3A.

0.17 Chapter 3 deals with the suitability of Part 5.1 creditors' schemes of arrangement for rehabilitating large and complex enterprises.

0.18 This Paper does not deal with various cross-border issues in the rehabilitation of large and complex enterprises, including coordination and cooperation in proceedings in different jurisdictions. These matters are the subject of the Australian

Government's Corporate Law Economic Reform Program *Proposals for Reform Paper No 8*.

0.19 This Paper does not cover informal 'workouts', in the form of voluntary contractual undertakings amongst creditors, aimed at rehabilitating financially distressed companies.⁵

Acknowledgments

0.20 The Advisory Committee thanks Howard Seife of Chadbourne & Parke LLP, New York, and Robert K Rasmussen, Professor of Law, Vanderbilt Law School, for the generous advice each of them has provided on the law and practice of US Chapter 11.

0.21 The Advisory Committee also acknowledges detailed written submissions provided by Leon Zwier of Arnold Bloch Leibler, Melbourne, who is the legal adviser to the Ansett administrators, Ferrier Hodgson who are the Pasmenco administrators and Geoff Sutherland of Coudert Brothers, Sydney. The Advisory Committee Executive also consulted various other insolvency practitioners and experts, both in Australia and in the UK, and thanks them for their contribution.

Concept of 'large and complex enterprise'

0.22 This Paper focuses on large and complex enterprises, as requested in the terms of reference. This concept cannot be precise, given that complexity may be a product of the financing arrangements and any corporate group structure adopted, rather than merely the size of an enterprise or whether or not it is listed. Other intangible factors may include the significance of the enterprise for the Australian economy and its place in the market sector in which it operates.

0.23 For the purpose of the discussion in this Paper, whether an enterprise is large and complex could be determined according to minimum thresholds regarding one or more of the following:

- revenues
- liabilities
- number of creditors and outstanding contracts
- number of employees
- number of active subsidiaries or other related companies

⁵ The practical and legal issues involved in informal workouts are discussed in the Paper by John Stumbles, *Workouts*, delivered at the 20th Annual Banking and Financial Services Law and Practice Conference, August 2003. He points out that these contractually based agreements may be less costly and more flexible than legislative rehabilitation procedures and avoid some of their legal consequences, for instance the triggering of default clauses. However, workouts do not protect directors from personal liability for any insolvent trading by the company during the workout period. Workouts also raise their own legal issues, such as the circumstances in which those creditors who are involved in decisions concerning the continuing conduct and management of the company might become its shadow directors. This shadow director issue does not arise under VAs, where an external administrator takes over control of the company.

- number of locations or operations in Australia or elsewhere.⁶

The court could have a residual discretion to declare an enterprise to be a ‘large and complex enterprise’, even if it does not satisfy a minimum number of these criteria.⁷

0.24 Alternative approaches would be to:

- leave it to the court to determine when an enterprise is ‘large and complex’, for the purpose of any provisions that apply to this category of enterprises, or
- leave it to the administrator of the rehabilitation procedure to determine whether to utilise any large and complex enterprise provisions, given that complexity may arise from the types of business issues facing the administrator.

0.25 In light of the matters raised in this Paper, respondents might wish to put forward suggestions on whether any definition of large and complex enterprises is necessary and, if so, what form it might take.

Parliamentary Issues Paper

0.26 The Parliamentary Joint Statutory Committee on Corporations and Financial Services, as part of its Inquiry into Australia’s insolvency laws, published an Issues Paper in May 2003.

0.27 Questions relevant to VAs that are dealt with in the Parliamentary Paper, but not in this Discussion Paper (as they do not specifically raise issues for large and complex enterprises), are:

- independence of administrators⁸
- the removal of administrators⁹ (though both the Issues Paper and this Discussion Paper cover an administrator exercising a casting vote on a removal application¹⁰)
- the obligations of administrators to report suspected breaches to ASIC¹¹
- the terms of deeds of company arrangement¹²
- the treatment of employee entitlements¹³
- taxation implications.¹⁴

⁶ An example of a large enterprise is found in *Re Pan Pharmaceuticals Ltd* [2003] FCA 598. The enterprise in that case:

- employed approximately 250 staff
- had creditors’ claims of some \$27 million involving some 1000 contracts
- supplied over 4500 products to some 700 outlets, and
- exported some 37% of its total output to 39 countries.

⁷ A precedent for this type of approach is s 411(1B).

⁸ Issues Paper, paras 1.7–1.17.

⁹ id, paras 1.25–1.26.

¹⁰ Issues Paper, paras 1.62–1.66; this Discussion Paper, paras 2.101–2.111.

¹¹ Issues Paper, paras 1.129–1.130.

¹² id, paras 1.131–1.138.

¹³ id, paras 1.107–1.128.

¹⁴ id, paras 1.91–1.92.

The Parliamentary Issues Paper is found at:

http://www.aph.gov.au/senate/committee/corporations_ctte/ail/issuespaper.doc

Invitation for submissions

0.28 The Advisory Committee invites submissions on the following matters in so far as they apply to large and complex enterprises:

- whether each of the general principles identified in Chapter 1 is appropriate for assessing the suitability of any rehabilitation procedure for these enterprises
- whether any other general principles are relevant to this assessment
- whether, in light of the analysis of the principles in Chapter 1, all or some features of Chapter 11 of the United States Bankruptcy Code should be adopted in Australia for these enterprises and, if so, whether they should replace VA, be incorporated into VA or be an alternative to VA
- whether, in light of the analysis of the principles in Chapter 1, any features of the UK legislation should be adopted for these enterprises
- any other matter concerning these enterprises that is relevant to Chapter 1
- any issue or policy option concerning these enterprises that is raised in Chapter 2
- any matter concerning these enterprises that is raised in Chapter 3
- any other issue or policy option concerning these enterprises that is relevant to this review.

0.29 Please send your submission to:

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If you have any queries, please phone (02) 9911 2950.

0.30 If you are sending your comments otherwise than by email, please also send, if possible, a computer disk containing your submission, using Microsoft Word for Windows 2000.

0.31 Please note that submissions on this Discussion Paper may be published on the CAMAC Website, unless marked Confidential.

Closing date for submissions

0.32 Please forward your submissions by **Friday 28 November 2003**.

Further copies

0.33 This Discussion Paper is available under *What's New* on the Advisory Committee's Website www.camac.gov.au.

The Advisory Committee

Functions

0.34 The Corporations and Markets Advisory Committee is constituted under Part 9 of the Australian Securities and Investments Commission Act 2001.

0.35 Section 148 of that Act sets out the functions of the Advisory Committee:

CAMAC's functions are, on its own initiative or when requested by the Minister, to advise the Minister, and to make to the Minister such recommendations as it thinks fit, about any matter connected with:

- (a) a proposal to make corporations legislation, or to make amendments of the corporations legislation (other than the excluded provisions); or
- (b) the operation or administration of the corporations legislation (other than the excluded provisions); or
- (c) law reform in relation to the corporations legislation (other than the excluded provisions); or
- (d) companies or a segment of the financial products and financial services industry; or
- (e) a proposal for improving the efficiency of the financial markets.

Advisory Committee Members

0.36 The members of the Advisory Committee are selected by the Minister in their personal capacity from throughout Australia on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

0.37 The members of the Advisory Committee are:

- Richard St John (Convenor)
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Barbara Bradshaw—Chief Executive Officer, Law Society Northern Territory, Darwin
- Philip Brown—Emeritus Professor, University of Western Australia, Perth
- Berna Collier—Commissioner, Australian Securities and Investments Commission (alternate to David Knott)
- Susan Doyle—Chairman, Australian Government Employees Superannuation Trust, Sydney (until August 2003)
- Greg Hancock—Managing Director, Hancock Corporate & Investment Services Pty Ltd, Perth
- Merran Kelsall—Company Director, Melbourne
- David Knott—Chairman, Australian Securities and Investments Commission
- John Maslen—Chief Financial Officer and Company Secretary, Michell Australia Pty Ltd, Adelaide
- Louise McBride—Partner, Deloitte Touche Tohmatsu, Sydney
- Marian Micalizzi—Chartered Accountant, Brisbane
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, The Seidler Law Firm, Sydney
- Nerolie Withnall—Consultant, Minter Ellison, Brisbane.

Legal Committee Members

0.38 The Advisory Committee is assisted in its work through the legal analysis and advice it requests from its Legal Committee. The members of the Legal Committee are selected by the Minister in their personal capacity from throughout Australia on the basis of their expertise and experience in corporate law.

0.39 The members of the Legal Committee are:

- Nerolie Withnall (Convenor)—Consultant, Minter Ellison, Brisbane
- Elspeth Arnold—Partner, Blake Dawson Waldron, Melbourne
- Ashley Black—Partner, Mallesons Stephen Jaques, Sydney
- Elizabeth Boros—Professor of Law, Monash University, Melbourne

- Suzanne Corcoran—Professor of Law, Flinders University, Adelaide, and Professorial Fellow, Australian National University, Canberra
- Damian Egan—Partner, Murdoch Clarke Cosgrove & Drake, Hobart
- Brett Heading—Partner, McCullough Robertson, Brisbane
- Jennifer Hill—Professor of Law, University of Sydney
- Francis Landels—Chief Legal Counsel, Wesfarmers Ltd, Perth
- Duncan Maclean—Partner, Cridlands Lawyers, Darwin
- Laurie Shervington—Partner, Minter Ellison, Perth
- Anne Trimmer—Partner, Minter Ellison, Canberra
- Gary Watts—Partner, Fisher Jeffries, Adelaide.

Executive

0.40 The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thamani Parrino—Executive Assistant.

1 Principles for effective corporate rehabilitation

This chapter identifies various principles for designing effective rehabilitation procedures for large and complex enterprises. It also discusses the different ways those principles are reflected in various jurisdictions.

Outline of principles

1.1 The likelihood of a large and complex corporate enterprise in serious financial difficulties successfully overcoming its problems and continuing in business as a going concern may depend on whether any available rehabilitation procedure:

- encourages the company to take early remedial action
- encourages the company to negotiate with its major creditors
- assists ongoing financing of the company during the rehabilitation period
- provides a rehabilitation timetable adjustable to the needs of the company
- provides methods to deal with enterprises structured as corporate groups.

1.2 The principal rehabilitation procedures compared in this chapter are voluntary administrations under the Corporations Act Part 5.3A (VA), Chapter 11 proceedings under the US Bankruptcy Code (Chapter 11) and an administration under Schedule B1 to the UK Insolvency Act 1986, as introduced by the UK Enterprise Act 2002 and in force from September 2003.¹⁵ Each of these procedures is designed to provide an opportunity for financially distressed companies, through a statutory moratorium on creditors' rights, to reorganise and continue in business if they have value as a going concern. However, the methods adopted for achieving this common goal often differ in fundamental respects, particularly between Chapter 11 and VA. By comparison, the 2002 UK amendments have more closely aligned the UK procedure with VA.

Encouraging companies to take early remedial action

Principle 1: The earlier a company responds to its financial difficulties, the better may be its prospects of successful rehabilitation.

1.3 In considering whether, and when, to embark on a rehabilitation procedure, the directors of a financially distressed company may be strongly influenced by:

- *the prerequisites for initiating that procedure.* Is it necessary that the company be insolvent, or at risk of insolvency, for directors to initiate a rehabilitation?
- *who controls that procedure.* Will the directors, or some external appointee, control the company during the rehabilitation period?

¹⁵ New Zealand is currently reviewing its business rehabilitation laws: Ministry of Economic Development Insolvency Law Review, *Business Rehabilitation: Discussion Document* (May 2002).

- *personal liability of directors for insolvent trading*. Do directors obtain any immunity from possible liability for any debts incurred by the company during the rehabilitation period?

1.4 Directors may also be concerned about the likely market response to the company entering into a rehabilitation procedure, as well as the possible loss of the company's, and their own, commercial reputation. These concerns may be less acute if there is a reasonable prospect of the company successfully emerging from rehabilitation to continue in business as a viable concern.

1.5 Some of these factors are interrelated. For instance, permitting solvent companies to initiate a rehabilitation procedure may strengthen the argument for leaving the board of directors in control of the procedure. A contrary view is that, even if early intervention for solvent companies is permitted, some creditors may be unwilling to cooperate in any rehabilitation procedure unless they have the power to replace incumbent management.

Prerequisites for initiating the procedure

1.6 These prerequisites should not unduly inhibit companies from undertaking remedial action, though they should not provide a means for companies merely to delay or defeat particular creditors' rights, rather than to undertake a genuine and realistic restructuring to deal with their financial difficulties.

1.7 Some possibilities include:

- *a financial stress test*: for instance, actual or likely insolvency
- *a purposive test*: for instance, a requirement that any procedure be initiated in good faith.

Financial stress test

1.8 A requirement of actual or likely insolvency, as under VA¹⁶ and the UK provisions, seeks to ensure that the rehabilitation procedure is only available to companies at clear risk of financial demise. However, it would be detrimental if directors saw the procedure as unavailable to them until their companies were in acute financial difficulty and delayed action until insolvency was inevitable. A somewhat different concern is that to permit insolvent companies to invoke the rehabilitation procedure may result in that procedure unduly supporting, or prolonging the life of, companies that should immediately be liquidated.

Purposive test

1.9 The US Bankruptcy Code does not have any financial stress or other prerequisite test for Chapter 11. Instead, US Bankruptcy Courts require that any application for Chapter 11 protection be made 'in good faith'. This judicial criterion was introduced in the 1970s in response to concerns that an insolvency test could be very difficult to apply in particular cases. It could lead to creditors attempting to forestall Chapter 11 proceedings by arguing that the company was not insolvent, while pursuing their own claims.

¹⁶ Section 436A requires that the directors seeking to appoint an administrator be of the opinion that 'the company is insolvent or is likely to become insolvent at some future time'.

1.10 To avoid possible misuse by irreversibly insolvent companies, US Bankruptcy Courts may at any time dismiss Chapter 11 proceedings for want of good faith if they consider that a company has no realistic chance of reorganising its business and is attempting merely to avoid or postpone creditors exercising their rights:

The clearest case of bad faith is where the debtor enters Chapter 11 knowing that there is no chance to reorganise his business and hoping merely to stave off the evil day when the creditors take control of his property.¹⁷

1.11 US Bankruptcy Courts also employ the good faith requirement to stop clearly solvent companies petitioning under Chapter 11 simply to obtain a debt holiday or some other commercial advantage.

[The Bankruptcy Courts] have consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganise under the protection of Chapter 11.¹⁸

Assessing the tests

1.12 An argument for a financial stress test is that it would overcome any possibility of a clearly solvent company commencing a rehabilitation procedure merely to give itself temporary immunity from its unsecured creditors. Also, on one view, any ‘good faith’ only prerequisite for a corporate rehabilitation procedure would require giving the courts a supervisory role (similar to that of the US Bankruptcy Court), rather than only an ancillary role (as under VA).

1.13 A contrary view is that the UK and Australian provisions already have some requirements that could counter abuse if a ‘good faith’ only prerequisite was introduced into those jurisdictions. For instance, the UK legislation requires that an administrator, on appointment, be satisfied that the purpose of the administration is reasonably likely to be achieved, for instance to rescue the company as a going concern or achieve a better result for the company’s creditors as a whole than would be likely if the company were wound up prior to the administration. In Australia, a court may terminate a VA if satisfied that the VA provisions are being abused.¹⁹

1.14 The possible grounds for commencing a rehabilitation procedure are further discussed in the context of VA at paras 2.19–2.32, post.

Who controls the procedure

1.15 The tasks facing anyone controlling the rehabilitation of a financially distressed company include to:

- make an early and accurate assessment of the prospects of, and options for, a successful restructuring
- apply, or employ, the expertise necessary to overcome any operational difficulties that caused the company to find itself in serious financial difficulties.

1.16 Possible controllers include:

¹⁷ *In re James Wilson Associates*, 965 F.2d 160, 170 (7th Cir. 1992), quoted in DG Baird, *Elements of Bankruptcy* (3rd edn, Foundation Press, New York, 2001) at 204. Any creditor may make an application for dismissal of a Chapter 11 proceeding on the basis that it was initiated in bad faith.

¹⁸ *SGL Carbon Corp.*, 200 F.3d 154, 166 (3d Cir. 1999).

¹⁹ s 447A(2).

- an external insolvency practitioner
- the board of the company
- anyone chosen by the board
- anyone chosen by the creditors.

External insolvency practitioner

1.17 On one view, the directors and managers who controlled the company's affairs when the company encountered financial difficulties should relinquish office, at least during the rehabilitation period. Those persons may have contributed to the company's financial problems through inappropriate business strategies or policies, inexperience, incompetence or even fraud. Also, having an external insolvency practitioner take over the affairs of the company, as under VA and the UK provisions, may provide much greater reassurance to creditors that their interests are being fully considered.

1.18 Some external administrators may have greater experience than the company's management in devising a means to avoid or overcome insolvency. Furthermore, the expertise of directors and other managers is not lost if they are prepared to remain with the company and assist or advise the external administrator, over and above providing necessary information.²⁰

1.19 A problem with confining administrators to insolvency practitioners is that the expertise and experience of some practitioners may not lie in rehabilitating or running companies.²¹ Also, the company may suffer considerable further decline in the initial period while an external appointee becomes acquainted with its business (though the company's further decline may occur even if it stays under the control of the board).

The board

1.20 Arguably, directors of a financially distressed company may be more willing to invoke a rehabilitation procedure, where, as under Chapter 11, the board retains control of the company. The Chapter 11 company can determine whether to retain all or some of the incumbent board or management or replace them with new office holders.²² The company can also choose to employ outside expertise, such as 'turnaround' professionals, to assist the rehabilitation.

1.21 On one view, any incumbent directors and managers that are retained may have a far better knowledge of the company and its businesses, and therefore be better placed to make any necessary ongoing commercial decisions, than an external insolvency practitioner.

²⁰ Subsection 438B(3) requires the directors of a company under administration to provide the administrator with 'such information about the company's business, property, affairs and financial circumstances as the administrator reasonably requires'.

²¹ For instance, the VA provisions stipulate that administrators must be registered liquidators (s 448B). One of the prerequisites for being registered as a liquidator is experience in winding up companies (s 1282(2)(b)).

²² R Broude, 'How the rescue culture came to the United States and the myths that surround Chapter 11' *Australian Insolvency Journal* April/June 2003 4 at 8 quotes research showing that a large proportion of managers of companies that go into Chapter 11 subsequently lose their positions in that company: 'The debtor in possession is the company, not the individual. Companies survive: managers most often do not, at least in their jobs'.

1.22 By contrast, much of the expertise of directors and other management may be lost if an external administrator is appointed, given that these executives may see little future for themselves in the company and may seek employment elsewhere. In some instances, a company may benefit if this expertise can be retained.

1.23 It is possible that the board of directors, if left in control, may act through self-interest or otherwise not in the overall best interests of the company and its creditors, for instance by selling the company's property to associates. Some directors may be deterred from this conduct, given that it may constitute a breach of their statutory or common law fiduciary duties. In addition, the likelihood of this occurring may be reduced by:

- creditors applying to the court to halt an asset sale (as is permitted under Australian law²³ as well as under Chapter 11), or
- prohibiting any significant asset sale unless the court approves that sale on being satisfied that the process has been conducted in a fair and reasonable manner in consultation with major creditors and that the directors, or other involved managers, have no significant direct or indirect financial interest in the purchaser.²⁴

1.24 One variation is to permit the board of directors to retain control only while the company is solvent. An independent third party would be required to take control of any company that is or becomes insolvent.

Anyone chosen by the board

1.25 One option, if the board itself is not permitted to retain office, is to allow it to choose as the corporate rehabilitator any person(s) having, in the opinion of the board, appropriate expertise, skills or experience to achieve a successful rehabilitation.²⁵ In the US, for instance, a corporate 'turnaround' profession has developed, comprising persons with a range of skills relevant to corporate rehabilitation.

Anyone chosen by the creditors

1.26 Another possibility is to permit the creditors to choose whomever they wish to run the company during the rehabilitation period. Their choice of appointees could include:

- one or more directors or other executives of the company in whom they retain confidence, or
- any external person(s), whether or not an insolvency practitioner, having, in the opinion of the creditors, the ability to successfully rehabilitate the company.

²³ Any adversely affected person, which may include a creditor, may seek an injunction under s 1324 to prevent an asset sale by directors that would breach the directors' statutory fiduciary duties under Part 2D.1 of the Corporations Act.

²⁴ This approach was put forward in the *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendations 18–25.

²⁵ Compare the recommendation in the Report of the Working Party *Review of the Regulation of Corporate Insolvency Practitioners* (AGPS, June 1997) paras 1.13, 6.18–6.74 that persons with specialised expertise relevant to one-off administrations be permitted to conduct those administrations, notwithstanding that they are not registered liquidators.

Regulation of persons other than insolvency practitioners

1.27 Insolvency practitioners (who currently conduct VAs) are subject to external regulation through the registration system for liquidators. This requires (among other things) that they be ‘fit and proper’ to perform their duties. Persons who fail to act accordingly may have their registration cancelled.²⁶ Permitting other persons to control a rehabilitation may raise questions about whether provision needs to be made to ensure their accountability for the powers they exercise. These persons would be officers of the company and therefore subject to the fiduciary duties that pertain to that office.²⁷ A possible additional protection would be to adopt the UK provision that all administrators are officers of the court, whether or not appointed by the court (though in the UK only insolvency practitioners may be administrators).

Consequences

1.28 Whether an external insolvency practitioner, the board of directors or any person chosen by the board or by the creditors should control the rehabilitation procedure has consequences for:

- the role of the court
- the role of creditors’ committees.

Role of the court

1.29 *Essential role under Chapter 11.* The US rehabilitation procedure is initiated by the directors filing a petition in the Bankruptcy Court, which thereafter is closely involved in the corporate reorganisation, given the need for ongoing external supervision of the company’s board of directors. For instance, the Court can replace the board with a trustee if it considers that the directors have been fraudulent, dishonest or incompetent or have grossly mismanaged the company.²⁸ Also, creditors may challenge the decisions of the board in court or request the court to appoint an examiner, whose role may include providing information to the court or mediating disputes between parties in Chapter 11 litigation.²⁹ Also, a reorganisation plan cannot proceed without the prior approval of the court.

1.30 A recent study concludes that professional fees and expenses awarded by the US Bankruptcy Courts in Chapter 11 proceedings by large public companies range from 1% to 3% of the total value of the company’s assets as at the commencement of

²⁶ s 1282.

²⁷ s 9 definition of ‘officer’, ss 180–184. On the matter of whether voluntary administrators are fiduciaries, see further Justice R Austin and R Brown, ‘Voluntary administrators as fiduciaries’ in I Ramsay (ed), *Key Developments in Corporate Law and Trusts Law* (LexisNexus Butterworths Australia 2002) 193–200.

²⁸ The Canadian rehabilitation procedure, like Chapter 11, leaves the board of directors in control of the company, subject to court supervision. A Canadian Joint Task Force has proposed giving Canadian courts powers where necessary to appoint an external administrator or replace all or some of the company’s directors: *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendations 38, 39.

²⁹ Similarly, the Canadian Companies’ Creditors Arrangements Act permits the court to appoint a monitor over the company’s affairs. That person may be the company’s auditor. The monitor has access to the company’s property, including its premises, and to financial information, including books, records, documents and electronic data, for the purpose of assessing the company’s business and financial affairs. The monitor must also report to the court on any material adverse financial changes in the company’s affairs. The debtor company has a statutory obligation to assist the monitor in carrying out its duties.

those proceedings. These percentage costs have been progressively reducing since the early 1980s as the judicial procedures under Chapter 11 have become more streamlined.³⁰

1.31 *Limited role under VA.* This procedure does not require court involvement or approval, given that it is in the hands of an external administrator. Instead, the court has general discretionary powers, as well as specific powers (for instance, to extend time periods), exercisable on application by the administrator or other interested parties.

Creditors' committees

1.32 *Prominent role under US procedure.* The lack of an independent administrator under the US procedure can result in extensive reliance on creditors' committees to investigate and negotiate with the board of directors. These committees are entitled to employ lawyers, accountants and other professionals to review the directors' proposals and, if necessary, their conduct. The costs of these experts are met from the company's assets. Some commentators have argued that so many committees and their ability to appear before the Bankruptcy Court, with all costs being paid from the company's assets, can unduly elongate and complicate the Chapter 11 procedure. The costs of creditors' committees may be relatively more burdensome for smaller than for larger enterprises.

1.33 *Limited role under VA.* The VA provisions also provide for committees of creditors. Their functions are:

- to consult with the administrator about matters relating to the administration, and
- to receive and consider reports by the administrator.

1.34 Unlike under Chapter 11, creditors' committees of companies in VA have no general power to employ professional advisers at the expense of the debtor company, given that the company is being run by an external administrator answerable to, and able to be replaced by, the creditors. If necessary, court approval can be sought to cover any costs if expert advice is obtained.³¹

Personal liability of directors for insolvent trading

1.35 Under Australian, but not US, law, company directors have a statutory duty to prevent insolvent trading. Failure to do so may result in civil as well as criminal liability, subject to various defences.³²

1.36 Under US Chapter 11, the board of directors retains control of the company throughout the rehabilitation period. The issue for directors of liability for insolvent trading does not arise in the US, which has no equivalent of the Australian insolvent trading provisions.

³⁰ LM LoPucki & JW Doherty, 'The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases' *Journal of Empirical Legal Studies*, January 2004 (forthcoming).

³¹ C Anderson & D Morrison, *Crutchfield's Corporate Voluntary Administration* (3rd Edition, Lawbook Co, 2003) at 251 have suggested that a creditors' committee may sometimes want to obtain independent accounting or legal advice during the administration or in relation to the drafting of the deed of company arrangement and could request the administrator to meet those costs. The administrator could then seek directions from the court granting an indemnity for the costs.

³² ss 588G ff. See generally HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (loose leaf, Butterworths) at [20.080]–[20.150].

1.37 Under VA, directors are replaced by an external administrator. This loss of office protects directors from possible liability for any insolvent trading by the company during the administration period. However, the interests of creditors are protected by imposing personal liability on the administrator for various debts incurred during the course of the administration, with the administrator having a right to an indemnity out of the company's assets.

1.38 Should the insolvent trading provisions apply to debts incurred during a VA if, as under the Chapter 11 model, directors were permitted to retain control of the company? From one perspective, the insolvent trading provisions assist corporate commerce by allowing creditors to assume at the time they contract with a company that the company can pay its debts as and when they fall due. This solvency assumption, which is particularly important for unsecured creditors, can no longer be made once a company has publicly acknowledged its financial difficulties by embarking on a rehabilitation procedure such as a VA. Arguably, it would be inappropriate to apply the insolvent trading provisions to debts incurred by a company during a VA. Rather, directors who remained in control should be in a similar position to external administrators under a VA, namely they should be personally liable for various debts of the company incurred in that period, with rights to an indemnity out of the company's assets.

Encouraging companies to negotiate with creditors

Principle 2: The prospect of a financially distressed company being rehabilitated may be improved if it can be encouraged to enter into discussions with its major creditors as early as possible on how best to rectify its financial position.

1.39 On one view, a company may be more forthright in disclosing its financial problems to its major creditors, and entering into discussions with them, if those creditors cannot simply pre-empt any rehabilitation proposal raised by the directors by immediately enforcing any possessory, sale or other default rights, which may strip the company of key assets and undermine any prospect of rehabilitation.

1.40 A contrary view is that giving some secured creditors a pre-emption right may encourage a financially distressed company to talk with them to avoid the possibility of those creditors exercising those rights if the company unilaterally initiates a rehabilitation procedure. That prospect may suffice to change the strategy of an ailing or mismanaged company and force it to the negotiating table for the benefit of all interested parties, including other creditors and the shareholders. Also, any diminution of a secured creditor's rights to protect and enforce its security could discourage financial institutions from providing funds to companies in the first place or adversely affect the terms of that funding.

1.41 Australia, the UK and the US have quite different approaches to the rights of particular creditors to stand outside a rehabilitation procedure, with VA making greater allowance for the rights of secured creditors than Chapter 11 or the UK legislation.

Australia

1.42 Lenders and suppliers to large and complex enterprises can protect their interests through various financial arrangements, some of which allow them to exercise default rights regardless of a VA.

Substantial and other chargees

1.43 A company may agree to a lender holding a charge over all, or substantially all, its property (a substantial chargee), though this may be more likely with smaller enterprises. A substantial chargee can in effect override a VA by exercising its rights to enforce its security, for instance by appointing a receiver, within 10 business days of being notified by the company that an administrator has been appointed.³³ Also, any other secured creditors who have commenced their enforcement action before the commencement of the VA can elect to continue with that action and enforce their security rights.³⁴

Ipso facto clauses

1.44 Creditors can enforce contractual ipso facto clauses, which have the effect of placing a company in default in circumstances short of insolvency or entry into a VA (or other external administration procedure), for instance where there has been any ‘material adverse change’ in a company’s financial circumstances. The rights of the creditor upon any such default depend on the nature of the charge or other security. Ipso facto clauses are further discussed in the context of VAs at paras 2.191–2.206.

Set-offs

1.45 Any creditor who is also a debtor of the company can stand outside a VA to the extent that the creditor can set off any debts the company owes to it against any debts it owes to the company. Set-off rights are further discussed in the context of VAs at paras 2.168–2.172.

Reservation of title clauses

1.46 These clauses, sometimes referred to as Romalpa clauses, provide that title to goods does not pass from the vendor to the purchaser until they have been paid for. The vendor may repossess the goods in the event of default. If a corporate purchaser goes into VA without having paid for the goods, the effect of the VA is to freeze the vendor’s repossession rights. However, these rights revive when a company enters into a deed of company arrangement, unless the deed provides for the vendor to be paid in full, the vendor has agreed to some compromise of those rights under that deed or the court orders that the vendor’s repossession rights not revive, on being satisfied that the vendor is otherwise adequately protected.³⁵

UK

1.47 Prior to recent amendments, a substantial chargee in the UK had the same rights as currently apply in Australia to, in effect, bypass the rehabilitation procedure by appointing a receiver. The practice had developed of financiers taking a largely worthless floating charge (known as a ‘lightweight’ or ‘featherweight’ charge) over the whole, or substantially the whole, of a company’s property for the sole purpose of

³³ s 441A, s 9 definition of ‘decision period’.

³⁴ ss 441B, 441F.

³⁵ ss 444D, 444F. The Advisory Committee’s *Corporate Voluntary Administration Report* (June 1998) paras 4.20 ff and Recommendations 23 and 24 outline the rights of the reservation of title creditor under the current law and propose that administrators and those creditors be permitted to sell property subject to a reservation of title clause in some circumstances.

being able to override the appointment of an administrator and install their own receiver.³⁶

1.48 However, under recent amendments, the holders of most floating charges created after the commencement of those amendments in September 2003 will no longer be able to pre-empt an administration by appointing a receiver over the company's property.³⁷ Instead, they will be limited to appointing an administrator.

1.49 The UK Government White Paper that led to these amendments argued that this restriction on creditors initiating receiverships was necessary in light of the large number of UK receiverships in the 1990s, which 'may have represented precipitate behaviour on the part of lenders, causing companies to fail unnecessarily'.³⁸ The White Paper also pointed out that a receiver's principal obligation is towards the appointor, in contrast to an external administrator, who must act in the interests of the creditors as a whole. In consequence, a receiver is substantially unaccountable to any other creditor for the way in which corporate assets are dealt with. The White Paper concluded that 'receivership should cease to be a major insolvency procedure', with holders of floating charges being required instead to initiate an administration 'in which all creditors participate, under which a duty is owed to all creditors and in which all creditors may look to an office holder for an account of his dealings with a company's assets'.³⁹

1.50 By comparison, receivers exercising any power of sale under Australian law must take all reasonable care to sell the property at 'not less than [its] market value or otherwise the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold'.⁴⁰ However, the timing of the sale is a matter for the receiver, acting in the interests of the secured creditor, whether or not that timing is best for other creditors.

1.51 Various policy options for dealing with the issues raised by receiverships in the context of VAs are discussed at paras 2.51–2.60.

US

1.52 The initiation of a Chapter 11 proceeding, by petition to the court, immediately freezes the proprietary and repayment rights of all secured (as well as unsecured) creditors as at that date, including persons with a charge over all or most of the company's property. In consequence, a secured creditor cannot seize any property subject to the charge, even if the company has defaulted on its obligations. This freeze also covers any security previously seized by a secured creditor, but not yet sold by that

³⁶ C Anderson & D Morrison, *Crutchfield's Corporate Voluntary Administration* (3rd Edition, Lawbook Co, 2003) at 146. J O'Donovan in *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at [17.190] points out that, where several chargees hold charges over the whole or substantially the whole of a company's property, any one of them may appoint a receiver 'even if their charges are fully subordinated to other charges. The English courts have accepted these so-called 'featherweight floating charges', even though they were created for the sole purpose of enabling the chargee to [appoint a receiver and therefore] prevent the appointment of an administrator'.

³⁷ UK Insolvency Act 1986 s 72A, introduced by the Enterprise Act 2002. There are several exceptions to this prohibition on appointing a receiver, including holders of floating charges created under any 'capital market arrangement' (ss 72B–72G). The legislation also permits the Government to terminate, or add to, these exceptions to the prohibition on the appointment of a receiver (s 72H).

³⁸ UK Department of Trade and Industry, *Productivity and Enterprise: Insolvency—A Second Chance* (July 2001) para 2.1.

³⁹ *Id.*, para 2.5.

⁴⁰ s 420A.

creditor before the petition is filed. There is no equivalent of the VA provisions permitting some secured creditors to exercise their proprietary rights, regardless of a VA.

1.53 The position of a debtor company is further strengthened by the statutory prohibition on creditors enforcing any ipso facto clauses (as explained in para 1.44, supra) or set-off rights.

1.54 Likewise, the US ‘cramdown’ rules permit the court to approve a reorganisation, despite the objection of one or more impaired classes of creditors, be they secured or unsecured, provided at least one impaired class assents and the proposed arrangement is generally ‘fair and equitable’ to any objecting class.⁴¹ A class is impaired if the plan would alter any of the legal rights of its members compared with their pre-Chapter 11 position.

1.55 Arguably, the debtor company’s ability to effect a freeze or automatic stay on creditors’ rights by commencing Chapter 11 proceedings, together with the cramdown rules, enhance the opportunities for directors to negotiate with creditors at an earlier stage to design a reorganisation package, to be subsequently implemented by the directors invoking Chapter 11. In turn, secured creditors who choose to provide a company in rehabilitation with further financing may have considerable power over the future conduct of that company through the terms and conditions they can impose on that funding (see paras 1.57–1.58, post). This method of informal pre-Chapter 11 negotiation (known as a ‘pre-pack’) may deliver ongoing finance to the company, while being more attractive to secured creditors than their running the risk of having their rights interfered with by the freeze and cramdown rules if the company invokes Chapter 11 without prior consultation.

Encouraging ongoing financing

Principle 3: A company may have a better prospect of successful recovery if it can obtain new loan or equity finance during the rehabilitation period.

Loan finance

1.56 Some companies may have no real prospect of financial recovery without the ability to borrow new funds, and thereby support their business activities, during the rehabilitation period.

US

1.57 The US rehabilitation procedure encourages new loan finance. The Bankruptcy Court may grant a lender to the company during the rehabilitation period a priority for repayment of the debt over all unsecured creditors. If necessary, the court may also grant that lender a priority that is senior or equal to existing secured creditors, provided that the rights of those secured creditors are otherwise ‘adequately protected’. The US experience is that existing secured creditors may often be willing to provide further loan finance to avoid their interests being postponed by a court giving priority to a subsequent lender. Lenders who provide further finance can also impose terms and

⁴¹ Some examples of the residual protections for an impaired class are given by R Broude, ‘How the rescue culture came to the United States and the myths that surround Chapter 11’ *Australian Insolvency Journal* April/June 2003 4 at 10.

conditions on the lending that give them considerable control over the corporate rehabilitation procedure, for instance the composition of the board or management or how the loan funds are utilised.

1.58 US courts can also grant a company under Chapter 11 the right to use as a security for other borrowing any ‘cushion of collateral’, that is, any difference between the value of the security and the lesser amount owed to the security holder (being the principal plus accrued interest). This would override any contractual prohibition on a company granting a subsequent charge over the security without the approval of the prior chargee. The size of the cushion of collateral, and therefore the funds obtainable, may sometimes be considerable, particularly where a prior chargee has taken a security over all or substantially all the assets of the company.

VA

1.59 Secured creditors in some VAs may be prepared to voluntarily relinquish their priority where they assess that they would receive considerably less if the company went into liquidation than if it could obtain new loan finance as a going concern. Also, secured creditors could adopt the US practice of lending further funds on terms and conditions that give them significant influence over the company’s future conduct (though they cannot displace the existing priority of any other secured creditors).

1.60 Apart from either of these possibilities, it is arguable that any interference with the rights of secured creditors, or with the equitable treatment of unsecured creditors, could adversely affect general corporate financing. Also, any repayment priority arrangements that enable a company to obtain loan funds on better commercial terms than other competing companies may give it an unfair trading advantage, undermining the principle of competitive neutrality.

1.61 The issue of loan finance in the context of VA is further discussed at paras 2.82–2.100.

Equity finance

1.62 Current Australian and overseas corporate rehabilitation procedures do not have specific provisions for providers of equity during the rehabilitation period. On one view, this omission provides little incentive for an existing or new shareholder to supply further equity capital during that period.⁴²

1.63 This raises the question whether a rehabilitation procedure should specifically give providers of new equity capital some form of voting or other rights in the rehabilitation procedure, thereby encouraging investors to take up new shares.

⁴² Contrast equity raising with equity for debt swaps, whereby creditors take equity in return for extinguishing all or part of the debts owed to them by the company: see further paras 2.134–2.160.

Timetable for completing the procedure

Principle 4: The procedural timetable needs to be sufficiently flexible to adjust to the needs of particular companies.

1.64 There are two time periods to consider:

- the time to develop a rehabilitation plan
- the time to implement that plan.

Developing a plan

1.65 US Chapter 11 generally gives the directors of a company the exclusive right for up to 6 months, or any longer period approved by the Bankruptcy Court, to develop a rehabilitation plan and have it accepted by creditors. By contrast, administrators under a VA have just over a month to complete this task, unless the court extends the time. The UK legislation takes a middle position, giving the administrator a maximum of ten weeks to develop proposals for consideration by creditors, though the court or creditors can extend that time period.

1.66 An argument for a longer statutory period for a large and complex enterprise is that any adequate review of its financial affairs, and the development of a rehabilitation plan that creditors will support, are almost impossible to achieve in the limited VA timeframe. Applications for court extensions are almost inevitable.

1.67 A contrasting view is that having relatively short timeframes and requiring the court to approve any extensions, as under VA, constitute a very useful ongoing check on the progress of the rehabilitation. For instance, administrators may need to provide information to the court about the company's current financial position and its future prospects as part of any extension application. Also, without some timing checks, much of the remaining value in a company could be lost by the company continuing to trade at a loss during any prolonged period while a rehabilitation plan is being worked out. Furthermore, the continuing restrictions on the company's creditors exercising their rights could threaten the creditors' own solvency, as well as disadvantage the company's trading competitors who do not have the benefit of this moratorium on creditors' rights. A court could take all these matters into account in deciding whether, and on what conditions, to grant any time extensions.

1.68 Timing issues in the context of VAs are further discussed at paras 2.61–2.76.

Implementing the plan

1.69 Under the UK procedure, an administrator's term of office, including any involvement in the implementation of a plan, must be completed within one year of the initial appointment. This time limit may be extended by the court or with the consent of all secured creditors and a majority by value of those unsecured creditors who vote. In other respects, the UK does not impose any time limits on the implementation of a rehabilitation plan, for instance, the moratorium period under that plan. The Australian and US rehabilitation procedures have no implementation time limits.

1.70 An argument for the UK approach is that it encourages a return of the company to internal management as soon as practicable. Creditors can extend the period of

external management if it is in their interests, though any secured creditor could, in effect, veto that extension. The court can grant an extension, even without creditor approval, for instance, where the court considers that it is in the overall interests of creditors that the administrator have a longer term role in the plan's implementation.

Methods for dealing with corporate groups

Principle 5: The process of rehabilitating a corporate group may be assisted if that group can be dealt with collectively, rather than on a company-by-company basis.

1.71 The Advisory Committee's *Corporate Groups Report* (May 2000) (available under *Final Reports* on the CAMAC Website www.camac.gov.au) made detailed recommendations dealing with the pooling of assets of corporate groups in VA and liquidations.⁴³ These recommendations recognise that the benefits for streamlined administration of treating companies in a corporate group collectively must be balanced against the rights of shareholders and creditors of particular group companies. The rules governing pooling must accommodate these sometimes competing interests.

1.72 These matters are further discussed in the context of VAs at paras 2.176–2.190.

Summary of key VA and Chapter 11 comparisons

1.73 The following table compares US Chapter 11 and the Australian VA provisions. The UK procedure is largely similar to VA, though the UK court retains a supervisory role over both court-appointed administrators and out-of-court appointees.

	VA	US Chapter 11
Prerequisites	Insolvency or likely insolvency.	Good faith only.
Who can commence the procedure	The directors, a liquidator or provisional liquidator or a substantial chargee.	The directors.
Role of the court in commencing the procedure and approving the plan	No mandatory role in either situation, though the court has various ancillary powers exercisable on application.	Procedure initiated by petition to the court. Continuing close court involvement in the rehabilitation procedure, including final approval of plan.
Who controls the company during the rehabilitation procedure	The administrator, who must be a registered liquidator.	The directors (unless the court orders their replacement by an independent trustee).
Committees of creditors	Limited functions, namely to consult with administrator in relation to the administration and consider reports by the administrator.	Major role. Can employ professional advisers at the company's expense.
Information to creditors	Report by the administrator about the company's business, property, affairs and financial circumstances and a recommendation about what is to be done.	Court-approved disclosure statement.
Moratorium on claims against the company	Automatic moratorium, with significant exceptions for some secured creditors and property owners.	Automatic moratorium, which applies to all secured and unsecured creditors.
Ability of creditors to enforce ipso facto clauses	Yes.	No.
Ability of creditors to exercise set-off rights	Yes.	No.

⁴³ Recommendations 20–24.

	VA	US Chapter 11
Liability for goods and services	Administrator personally liable, with a right to an indemnity out of the company's assets.	Company liable as debtor in possession, with debts having priority over pre-commencement unsecured debts.
Loan financing during rehabilitation procedure	Lender is an ordinary unsecured creditor of the company.	The court can give a lender a priority over all existing unsecured creditors and, if necessary, over existing secured creditors.
Who devises rehabilitation plan	The administrator.	The directors, usually in consultation with professional advisers, during the exclusivity period (see below). After the exclusivity period, any interested party, including the creditors.
Time to develop rehabilitation plan	Approximately one month, subject to the court extending the period.	Exclusivity period of 120 days.
Approval of rehabilitation plan	One meeting of all creditors.	Meetings of each class of creditors. 'Unimpaired' creditors deemed to have approved plan.
Majority required to approve the plan	50% majority by number and by value of all the creditors who vote.	Two-thirds in amount, and more than one-half by number, of creditors who vote, class by class. A dissenting class can be overridden by the 'cramdown' rules.
Rehabilitation plan binding secured creditors	Yes, if the secured creditor agrees or the court so orders.	Yes, provided: <ul style="list-style-type: none"> if impaired class of secured creditors, at least one impaired class assents the plan is fair and equitable.
Rehabilitation plan discriminating between creditors	The creditors can approve a deed that discriminates against particular creditors.	Under the 'absolute priority' rule, senior creditors are paid before junior creditors. All creditors are paid before shareholders. One class cannot receive less than another class with identical priority without the consent of its members.
Time to implement rehabilitation plan	No prescribed limit.	No prescribed limit.

Invitation for submissions on Chapter 1

1.74 The Advisory Committee invites submissions on the following matters in so far as they apply to large and complex enterprises:

- whether each of the general principles identified in this chapter is appropriate for assessing the suitability of any rehabilitation procedure for these enterprises
- whether any other general principles are relevant to this assessment
- whether, in light of the analysis of the principles in this chapter, all or some features of Chapter 11 of the United States Bankruptcy Code should be adopted in Australia for these enterprises and, if so, whether they should replace VA, be incorporated into VA to form a hybrid of the two procedures, or be an alternative to VA
- whether, in light of the analysis of the principles in this chapter, any features of the UK legislation should be adopted for these enterprises
- any other matter concerning the rehabilitation of large and complex enterprises that is relevant to this chapter.

2 Voluntary administration

This chapter reviews the voluntary administration provisions. Part A describes their principal features. Part B raises a series of issues concerning their application to large and complex enterprises, taking into account recent experience with the Ansett and Pasmenco administrations, as well as provisions in overseas rehabilitation procedures that could be accommodated within the VA structure.

Part A: Current law

Objectives of voluntary administration

2.1 The voluntary administration provisions in Part 5.3A of the Corporations Act, introduced in June 1993, provide for the business, property and affairs of an insolvent company to be administered in a way that:

- maximises the chances of the company, or as much as possible of its business, continuing in existence, or
- if that is not possible—results in a better return for the company’s creditors and shareholders than would result from an immediate winding up of the company.⁴⁴

Appointment of administrator

2.2 The procedure allows for the appointment of an administrator to take control of, investigate and make recommendations for dealing with the property and affairs of insolvent or near-insolvent companies.⁴⁵ An administrator can be appointed by the company itself,⁴⁶ a liquidator or provisional liquidator⁴⁷ or a chargee over all or substantially all the property of a company (a substantial chargee), where the charge is enforceable.⁴⁸ An administrator must notify a substantial chargee of his or her appointment, unless the chargee is the administrator’s appointor.⁴⁹ The chargee is then permitted to enforce the charge, either itself or through a receiver or other agent, within 10 business days of the administrator’s appointment.⁵⁰

2.3 While a company is under administration, the administrator has control of the company’s business, property and affairs and acts as the company’s agent.⁵¹ During

⁴⁴ s 435A.

⁴⁵ ALRC 45, vol 1, para 44.

⁴⁶ s 436A. This provision requires that the directors seeking to appoint an administrator be of the opinion that ‘the company is insolvent or is likely to become insolvent at some future time’.

⁴⁷ s 436B. This provision requires that the liquidator or provisional liquidator be of the view ‘the company is insolvent or is likely to become insolvent at some future time’.

⁴⁸ s 436C. The chargee may appoint an administrator if the charge has become, and is still, enforceable.

⁴⁹ s 450A(3), (4).

⁵⁰ s 441A, s 9 definition of ‘decision period’.

⁵¹ ss 437A, 437B.

that period, its officers (other than the administrator) cannot exercise any function, except with the administrator's written approval.⁵²

Moratorium

2.4 Once a company is under administration, there is a stay or moratorium on actions or proceedings against the company and its property. This moratorium applies to:

- secured creditors, with limited exceptions
- owners or lessors of property possessed, used or occupied by the company, with limited exceptions, and
- unsecured creditors.

2.5 The moratorium prevents:

- the company from being wound up voluntarily⁵³
- charges from being enforced⁵⁴ (except charges over all or substantially all the property of a company that are enforced within the 10 business day decision period,⁵⁵ charges where the enforcement action has begun before the appointment of an administrator⁵⁶ and charges over perishable property⁵⁷)
- an owner or lessor from recovering property which is being used by the company⁵⁸ (except where the owner or lessor has already begun to exercise rights to repossess the relevant property before the administrator was appointed⁵⁹ or where the property is perishable⁶⁰)
- proceedings against the company and any enforcement action in relation to proceedings already taken.⁶¹

2.6 Where a chargee (other than a substantial chargee, which can exercise its right to enforce its charge within the 10 business day decision period), owner or lessor has taken action before the beginning of the administration, the court has a discretion to make an order preventing enforcement action if satisfied that the persons involved can otherwise be adequately protected.⁶² This prevents particular chargees, owners or

⁵² s 437C.

⁵³ s 440A(1). Also, the court is to adjourn the hearing of an application for an order to wind up a company if the company is under administration and the court is satisfied that it is in the interests of the company's creditors for the company to continue under administration rather than be wound up (s 440A(2)).

⁵⁴ s 440B.

⁵⁵ s 441A, s 9 definition of 'decision period'.

⁵⁶ s 441B.

⁵⁷ s 441C.

⁵⁸ s 440C.

⁵⁹ s 441F.

⁶⁰ s 441G.

⁶¹ ss 440D, 440F, s 9 definition of 'enforcement process'.

⁶² ss 441D, 441H.

lessors from destroying the prospects of the business, provided their rights can be protected in some other way.⁶³

2.7 In addition to the moratorium on actions against the company under administration, there is a stay on creditors enforcing any guarantees given by directors (or their relatives) for any liability of the company.⁶⁴

Personal liability of administrator

2.8 Administrators are personally liable for various debts they incur on behalf of companies under administration,⁶⁵ but are entitled to an indemnity out of the companies' property for those debts.⁶⁶

First meeting of creditors

2.9 The administrator must hold a first meeting of creditors within five business days of appointment.⁶⁷ At this meeting, creditors decide whether to appoint a committee of creditors.⁶⁸ They also have the opportunity to replace the administrator with their own appointee.⁶⁹

Major meeting of creditors

2.10 The administrator, after investigating the affairs of the company, calls a further meeting of the company's creditors to decide the company's future. That meeting must be convened within 21 days of the appointment of the administrator (extended to 28 days for the Christmas and Easter periods) (the convening period)⁷⁰ and must be held no later than five business days after the end of the convening period.⁷¹ The court may extend the convening period.

2.11 At that meeting, the creditors may resolve:

- that the company execute a deed of company arrangement, or
- that the administration should end and the company be returned to the control of the directors, or
- that the company be wound up.⁷²

2.12 When calling the meeting, the administrator must give creditors a report giving his or her opinion, with reasons, about each of these options, the state of the company's

⁶³ Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 533.

⁶⁴ s 440J.

⁶⁵ ss 443A, 443B, 443BA.

⁶⁶ s 443D.

⁶⁷ s 436E.

⁶⁸ s 436E(1).

⁶⁹ s 436E(4).

⁷⁰ s 439A(1), (5).

⁷¹ s 439A(2). Creditors must be given five business days' notice of the meeting: s 439A(3). The latest time for holding the major meeting (unless the court extends the convening period: s 439A(6)) is therefore four weeks or, if the administration begins just before Christmas or Easter, five weeks from the beginning of the administration.

⁷² s 439C.

business, property, affairs and financial circumstances and, if a deed of company arrangement is proposed, a statement setting out details of the proposed deed.⁷³

Deed of company arrangement

2.13 If the creditors resolve to accept a deed of company arrangement, the deed must be executed by the company and the deed administrator.⁷⁴ The company must execute the deed within 21 days of the creditors' resolution (or such further period as the court allows on application within that 21 day period).⁷⁵ The deed administrator must execute the deed before, or as soon as practicable after, the company executes it.⁷⁶ The administration ends once the company becomes subject to the deed of company arrangement.⁷⁷ Deeds specify whether companies are to be administered by a deed administrator or by the company's directors.

2.14 Rehabilitation deeds normally take the form of either a moratorium deed (under which the company is permitted a period of time to pay its pre-commencement creditors in full), a compromise deed (under which pre-commencement creditors agree to accept a payment less than their full debt as a final settlement) or a combined moratorium and compromise deed.⁷⁸ A deed binds:

- all pre-commencement unsecured creditors of the company⁷⁹
- those pre-commencement secured creditors of the company who have voted for the deed⁸⁰
- those pre-commencement owners or lessors of property possessed, used or occupied by the company who have voted for the deed⁸¹
- the company⁸²
- the company's officers and shareholders⁸³
- the deed's administrator.⁸⁴

2.15 In addition, the court may order that dissident pre-commencement secured creditors and owners or lessors of property be bound to a deed where:

⁷³ s 439A(4).

⁷⁴ s 444B(6).

⁷⁵ s 444B(2).

⁷⁶ s 444B(5).

⁷⁷ s 435C(1)(b), (2)(a).

⁷⁸ A deed of company arrangement can also be used to achieve an orderly liquidation: *Young v Sherman* (2001) 40 ACSR 12 at para [123].

⁷⁹ s 444D(1).

⁸⁰ s 444D(1), (2). Strictly, a secured creditor who has voted against a deed is still 'bound by' it, as s 444D(1) provides that the deed binds 'all creditors'. There are restrictions on the rights of these persons to take court proceedings: s 444E, *J & B Records Ltd v Brashs Pty Ltd* (1995) 16 ACSR 285, 13 ACLC 458, *Roder Zelt-und Hallenkonstruktionen GmbH v Rosedown Park Pty Ltd* (1995) 17 ACSR 153, 13 ACLC 776. However, subject to these restrictions, a secured creditor who has voted against a deed may nevertheless realise or otherwise deal with its security: s 444D(2).

⁸¹ s 444D(1), (3). The legal rights and restrictions in relation to these creditors are similar to those for secured creditors (see previous footnote).

⁸² s 444G(a).

⁸³ s 444G(b).

⁸⁴ s 444G(c).

- enforcement of their rights would materially adversely affect the arrangement, and
- their interests are otherwise adequately protected.⁸⁵

2.16 Creditors bound by a deed may not take action against the company or its property without the leave of the court or make or proceed with an application for a winding up order.⁸⁶ Creditors may vary or terminate a deed of company arrangement.⁸⁷

Role of the court

2.17 Court approval is not required to conduct a voluntary administration. However, the court has general powers to make orders⁸⁸ and the administrator may seek directions concerning any matter arising in the administration.⁸⁹ In addition, the court has various specific powers, for instance, to extend time periods, to determine points of law, to remove an administrator, to make orders binding dissenting creditors, or to terminate a deed of company arrangement.⁹⁰

Part B: Issues

Format

2.18 The issues discussed in this part may apply to VAs generally, though in many instances they may have a greater significance, or create greater difficulties, for large and complex enterprises. The issues are generally discussed using the following format:

- a statement of the issue
- the Harmer Report (where relevant)
- current Australian law
- overseas laws (where relevant)
- policy options for amending the law.

In all instances, one policy option (that, for the sake of simplicity, is not repeated in each case) is to retain the current law.

⁸⁵ ss 444D(2), (3), 444F.

⁸⁶ s 444E.

⁸⁷ ss 445A, 445C(b), 445E, 445F.

⁸⁸ s 447A.

⁸⁹ s 447D.

⁹⁰ ss 439A(6), 444B(2)(b), 444D(2), (3), 444F, 445B, 445C(a), 445D, 445G. C Anderson & D Morrison, *Crutchfield's Corporate Voluntary Administration* (3rd Edition, Lawbook Co, 2003) at 241–256 analyse the court's powers in relation to voluntary administration.

Initiating an administration

The issues

2.19 What should be the grounds for initiating a VA?

2.20 Who should be entitled to initiate a VA?

The Harmer Report

2.21 The Harmer Report said:

The [VA] procedure will be available to companies with a debt problem, not just those that are hopelessly insolvent. A reasonable prospect of insolvency will be sufficient.⁹¹

2.22 The Report recommended that the directors, a liquidator or a chargee over all the property of a company should be entitled to appoint an administrator.⁹²

Current law

2.23 The directors may appoint an administrator if, ‘in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time’.⁹³ A liquidator or provisional liquidator can appoint an administrator on the same grounds.⁹⁴ A company is insolvent if, and only if, it is unable to pay all its debts, as and when they become due and payable.⁹⁵

2.24 A chargee over the whole, or substantially the whole, of a company’s property can also appoint an administrator ‘if the charge has become, and is still, enforceable’.⁹⁶ However, other creditors do not have this right of appointment.

Policy options: grounds for appointment

Prohibit appointment by directors when the company is insolvent

2.25 It has been suggested to the Advisory Committee that directors of an already insolvent company should not be permitted to appoint an administrator. Their only option should be to place the company in liquidation. Directors would have this power only where the company is ‘likely to become insolvent at some future time’. This submission considers that it is too late to implement a corporate recovery strategy with a reasonable prospect of success once the company is insolvent. This change may also inhibit attempts to resuscitate phoenix companies.

2.26 On the other hand, directors of insolvent companies may prefer to put those companies into VA rather than liquidation. VAs are quicker for directors to initiate and

⁹¹ para 56.

⁹² paras 63, 66.

⁹³ s 436A.

⁹⁴ s 436B.

⁹⁵ s 95A.

⁹⁶ s 436C.

therefore provide them with earlier protection from liability for insolvent trading⁹⁷ if the company continues to trade.

2.27 In any event, it may be beneficial to retain the right of a liquidator to appoint an administrator to an insolvent company, given that this may assist some companies to achieve one of the statutory goals of a VA, being ‘a better return for the company’s creditors and members than would result from an immediate winding up of the company’.⁹⁸

Permit appointment where there is ‘a reasonable prospect of insolvency’

2.28 The current requirement is that the company is insolvent or ‘is likely to’ become insolvent at some future time. The ‘is likely to’ reference implies a high degree of probability that the company will become insolvent. The test could be made more flexible by substituting the Harmer Report formulation of ‘a reasonable prospect of insolvency’, thereby allowing an administration to be commenced where insolvency is possible, though not necessarily probable.

Permit appointment when a solvent company is in financial difficulty

2.29 Another suggestion received by the Advisory Committee is that a solvent enterprise should be able to invoke a rehabilitation procedure, with protection from creditors, whenever it has serious financial difficulties. This suggestion is based on the Chapter 11 approach, which permits solvent (as well as insolvent) companies to seek the protection of Chapter 11 provided they are acting ‘in good faith’ in so doing. Protection prior to actual or likely insolvency could increase the chances of financial recovery and also avoid many complex issues that may arise on insolvency, such as insolvent trading and voidable transactions.

2.30 Permitting solvent companies to enter into VA would, however, shift the balance of power from shareholders to creditors. During the moratorium period, creditors have their recovery rights frozen, but in return can determine the future of the company through voting on the deed.⁹⁹ During that period, shareholders cannot (without court approval) withdraw from the company by transferring their shares.¹⁰⁰ They are also bound by any deed agreed by creditors.¹⁰¹ Solvent companies that wish to undertake a rehabilitation already have various other options, such as a Part 5.1 scheme of arrangement (see further Chapter 3) or an informal workout.

Application to corporate groups

2.31 There may be a problem in applying any prerequisite ground for appointment to a corporate group, given that only some of the companies in the group may satisfy that prerequisite. However, it may not be workable to confine a VA only to those companies, given the often inter-related nature of a corporate group’s activities and finances.

2.32 One possibility would be to permit all companies in a corporate group to go into VA where the group overall would satisfy a prerequisite, notwithstanding that some group companies, treated in isolation, may not.

⁹⁷ s 588G.

⁹⁸ s 435A(b).

⁹⁹ s 439C.

¹⁰⁰ s 437F.

¹⁰¹ s 444G(b).

Policy options: who should be entitled to appoint

2.33 The current law reflects the recommendations in the Harmer Report. That Report did not support creditors (other than an eligible chargee) being entitled to initiate a voluntary administration, arguing that this right would be impractical and detract from the voluntary nature of the procedure.¹⁰²

2.34 The Advisory Committee's *Corporate Voluntary Administration Report* recommended that individual creditors should be entitled to apply to a court for an order appointing an administrator.¹⁰³ The requirement for court approval would ensure that the company is protected from frivolous appointments of an administrator or attempts by an individual creditor to use a threat of appointment as a form of leverage. The current right of a creditor to petition the court for winding up should also remain.

Eligibility of a liquidator to be an administrator

The issue

2.35 Should there be any restrictions on the classes of liquidators who may act as the administrator of a large and complex enterprise? This Paper elsewhere raises the issue (paras 1.15–1.27) whether persons other than liquidators should be entitled to control the rehabilitation procedure.

Harmer Report

2.36 The Harmer Report recommended that only a restricted class of registered insolvency practitioners, similar to official liquidators, should be administrators.¹⁰⁴

Current law

2.37 Any registered liquidator can act as the administrator of a company or a deed of company arrangement.¹⁰⁵ No other person can do so.

Policy options

2.38 There are several possibilities if some restriction on the eligibility of a liquidator to be an administrator of a large and complex enterprise is considered necessary, including:

- narrowing the class of registered liquidators who may so act to senior insolvency practitioners, such as official liquidators,¹⁰⁶ given the expense and complexity of large administrations and the possibility of reducing the incidence of applications for removal of administrators, or
- requiring that the court approve a registered liquidator so acting.

¹⁰² para 65.

¹⁰³ Recommendation 44.

¹⁰⁴ paras 69, 943.

¹⁰⁵ s 448B. ASIC Policy Statement 40 sets out the experience criteria to be a registered liquidator.

¹⁰⁶ ASIC Policy Statement 24 deals with the registration of official liquidators.

Rights that override a VA

The issue

2.39 Should there be any changes to the current rights of some secured creditors to enforce their security despite a VA?

The Harmer Report

2.40 The Harmer Report recommended that a creditor holding a registered charge over all the property of a company should have an automatic right to enforce its charge against all the property of the company, provided it does so within seven days of the appointment of an administrator,¹⁰⁷ as:

Such a creditor, in enforcing its charge, is in a position to take possession of the whole of the property of the company and thus provide an ordered administration of the company's affairs, albeit one conducted for the benefit of a secured creditor rather than all creditors.¹⁰⁸

2.41 The Report also recommended an exemption from the moratorium for some other classes of secured creditors who have taken significant enforcement action before the appointment of the administrator, as well as for creditors who have security over perishable property.¹⁰⁹

Current law

Substantial chargees

2.42 The current law modifies the Harmer approach by permitting a creditor which holds a charge over 'the whole, *or substantially the whole*' of the property of the company (a substantial chargee) to continue with enforcement proceedings notwithstanding the initiation of the VA, provided it has commenced that action either before the VA commences or within 10 business days of being notified of the administrator's appointment.¹¹⁰

2.43 An alternative open to a substantial chargee is to agree with the administrator not to exercise its right to enforce the charge immediately, provided that the administrator gives that chargee written consent to its enforcing the charge at any time during the remainder of the administration.¹¹¹

2.44 Exercise by a substantial chargee of its right to appoint a receiver may deny an administrator any effective continuing role, other than reporting to unsecured creditors on how the actions of the receiver appointed by the chargeholder affect their position.

¹⁰⁷ para 68.

¹⁰⁸ para 67.

¹⁰⁹ para 103.

¹¹⁰ s 441A, s 9 definition of 'decision period'.

¹¹¹ Section 440B permits a person to enforce a charge on the property of the company during the administration with the administrator's written consent.

Other secured creditors

2.45 In other respects, the current law follows the Harmer Report. Other secured creditors, or lessors, who commence recovery proceedings before the commencement of the administration may continue with these proceedings, or restart those proceedings during the administration period, unless the court orders otherwise if satisfied that what the administrator proposes to do during the administration will adequately protect their interests.¹¹² There are also specific provisions for creditors who have rights over perishable property.¹¹³

US approach

2.46 The initiation by directors of a Chapter 11 proceeding, by petition to the court, immediately freezes the rights of all secured, as well as unsecured, creditors as at that date, including persons with a charge over all or most of the company's property. This freeze covers any security seized, but not yet sold, by a secured creditor before a petition is filed.

2.47 This automatic stay remains until the Chapter 11 proceedings are completed or the court earlier exempts particular secured creditors whose interests are not 'adequately protected' according to the criteria in the Bankruptcy Code. In general, secured creditors must be compensated for any shortfall in repayment of their debts that results from the value of the security decreasing after the company goes into Chapter 11.

2.48 Much of the Chapter 11 litigation concerns applications by particular secured creditors to lift the automatic stay to enforce their security, for instance, on the ground that the debtor has failed to provide the creditor with adequate protection. A successful creditor's application may in effect terminate the business, depending on the size of that creditor's debt.

UK change

2.49 The holders of most floating charges created after September 2003 will not be able to pre-empt an administration by appointing a receiver over the company's property.¹¹⁴ There are several exceptions to this prohibition on appointing a receiver, including holders of floating charges created under any 'capital market arrangement'.¹¹⁵ The legislation also permits the Government to terminate, or add to, these exceptions to the prohibition on the appointment of a receiver.¹¹⁶ However, all holders of floating charges will be able to appoint an administrator.

2.50 The Australian law, while permitting the appointment of receivers under floating charges, requires them, in exercising any power of sale, to take all reasonable care to sell the property at 'not less than [its] market value or otherwise the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold'.¹¹⁷ However, the timing of the sale is a matter for the receiver, acting in the interests of the secured creditor, whether or not that timing is best for the

¹¹² ss 441B, 441D, 441F, 441H.

¹¹³ ss 441C, 441G.

¹¹⁴ UK Insolvency Act 1986 s 72A, introduced by the Enterprise Act 2002.

¹¹⁵ ss 72B–72G.

¹¹⁶ s 72H.

¹¹⁷ s 420A.

unsecured creditors. An administrator, a deed administrator, a liquidator or ASIC may also seek a court order to fix the receiver's remuneration.¹¹⁸

Policy options

2.51 The general question is whether any parties, and if so who, should be entitled to exclude themselves from a VA. A receivership initiated by a substantial chargee is the most significant instance of this standing aside from a VA. The current law, if considered unsatisfactory, could be amended either by reducing the rights of secured creditors or adjusting their rights to give them more time to consider an appropriate course of action.

Reducing the rights of secured creditors

2.52 Options include:

- no creditor may appoint a receiver, or
- only a creditor with a charge over the whole of a company's property may appoint a receiver (the Harmer approach), or
- only very limited classes of substantial chargees may appoint a receiver (the UK approach), or
- a substantial chargee can appoint a receiver subject to giving the company notice of the appointment (say, 2 weeks). If, during that time, the company goes into VA, the chargee's right to appoint a receiver would be extinguished.

Amending the rights of secured creditors

2.53 Options include:

- retain the current right of a substantial chargee to appoint a receiver, subject to extending the initial decision period for appointing a receiver from 10 business days to, say, 15 business days, or
- retain the current right of a substantial chargee to appoint a receiver, subject to the 10 business day decision period for appointing a receiver not beginning until, say, three weeks after the initiation of the VA.¹¹⁹

2.54 Either change would avoid substantial chargees being forced into precipitate action by allowing them more time to receive information from the administrator about the company's state of affairs, which may assist them in determining whether to participate in the VA. However, neither option would detrimentally affect an administrator's right to an indemnity out of the assets of the company.¹²⁰

2.55 One option if a substantial chargee retains the right to appoint a receiver is to require the receiver to postpone a sale if postponement would benefit unsecured creditors, provided that the postponement does not materially disadvantage the secured creditor.

¹¹⁸ s 425.

¹¹⁹ Philip Hoser, 'Farewell to receiverships?' *Australian Insolvency Journal* September 2003.

¹²⁰ s 443E(3).

Partial exercise of secured creditors' rights

The issue

2.56 Should a secured creditor that has a charge over all or substantially all the property of a company (a substantial chargee) be permitted to exercise its proprietary rights over only some of the company's property?

Current law

2.57 Under the current law, a substantial chargee who exercises its right during the decision period to enforce the charge must do so 'in relation to all property of the company subject to the charge'.¹²¹ The substantial chargee does not have the choice of appointing a receiver to only some of that property.

Policy considerations

2.58 The effect of this 'all or nothing' rule is that a substantial chargee either has to enforce the charge in full (which may undermine any possibility of a corporate rehabilitation) or be completely bound by the moratorium.

2.59 On one view, a substantial chargee should have the choice of enforcing the charge over only some of the charged assets, leaving the other charged assets under the administration. The administrator could then decide whether a corporate rehabilitation or a liquidation was the more appropriate course of action, taking into account this reduced asset base.

2.60 A contrary view is that the 'all or nothing' rule ensures that a company's assets are administered either by a receiver or an administrator, without the problems that might arise from divided control of those assets.¹²² It may also be difficult to justify abandoning the principle of unified control by permitting substantial chargees to enforce their charges selectively while continuing to prohibit other secured creditors and owners of property from exercising their proprietary rights under an administration. Fragmentation of control would be contrary to the fundamental principles of VA and could significantly undermine its effectiveness.

Timing issues

The issue

2.61 Are the time limits in the VA procedure too short for large and complex enterprises?

The Harmer Report

2.62 The Harmer Report did not recommend a first meeting of creditors.

¹²¹ s 441A(1)(b).

¹²² Harmer Report para 67, quoted at para 2.40, supra.

2.63 The Report recommended that:

- an administrator should not be liable for rental payments for property leased by the company during the first seven days of an administration.¹²³ This would give the administrator time to decide whether to continue with existing rental arrangements
- a meeting of creditors to consider the administrator's report should be held within 28 days of the appointment of the administrator.¹²⁴ The Report supported a relatively short timeframe, as any moratorium can detrimentally affect the proprietary rights of creditors
- creditors' meetings could be adjourned, but the moratorium should cease after 35 days, unless the court approved an extension¹²⁵
- after creditors accept the proposal, the company and the deed administrator should execute the deed of company arrangement within 21 days.¹²⁶

Current law

2.64 Currently:

- the first meeting of creditors must be held within five business days after the administration begins¹²⁷
- an administrator has seven days to decide whether the company should continue to use or occupy leased property. An administrator who decides to continue use or occupation thereafter incurs personal liability for the lease costs, subject to a right to an indemnity out of the assets of the company¹²⁸
- the major meeting of creditors must be convened within 21 days of the appointment of the administrator (extended to 28 days for the Christmas and Easter periods) (the convening period)¹²⁹ and must be held no later than five business days after the end of the convening period¹³⁰
- the major meeting of creditors cannot be adjourned to a day that is more than 60 days after the first day on which the meeting was held¹³¹
- execution of the deed of company arrangement must occur within 21 days after the end of the major meeting of creditors.¹³² On execution, the moratorium ceases and creditors are bound by the deed.

¹²³ para 90.

¹²⁴ para 94.

¹²⁵ para 95.

¹²⁶ para 117.

¹²⁷ s 436E.

¹²⁸ s 443B(2). The court granted the Ansett administrators an additional seven days (14 days in total) to make that decision, given the high number of affected leases.

¹²⁹ s 439A(1), (5).

¹³⁰ s 439A(2). Creditors must be given five business days' notice of the meeting: s 439A(3). The latest time for holding the major meeting (unless the court extends the convening period: s 439A(6)) is therefore four weeks or, if the administration begins just before Christmas or Easter, five weeks from the beginning of the administration.

¹³¹ s 439B(2).

¹³² s 444B(2)(a).

2.65 These time limits may not suffice for an administrator of a large and complex enterprise to collect sufficient information to enable the administrator or the creditors to make informed decisions or for creditors to agree on the best way to deal with the company's affairs and settle a complex deed of company arrangement to put this into effect.¹³³ A contrary view is that the proprietary and contractual rights of creditors are frozen under VA. Any material extension of the time limits could further disadvantage these creditors.

2.66 The courts, however, have specific power to extend some time periods¹³⁴ and otherwise can utilise their general discretionary power.¹³⁵ In exercising their powers, the courts have recognised a tension between the broad aim of a speedy administration under Part 5.3A and the need to give an administrator sufficient time to prepare a report on the company and its affairs and provide an opinion to creditors to enable them to make an informed decision about the future direction of the company, namely whether the creditors should execute a deed of company arrangement (and, if so, giving details of any proposed deed), end the voluntary administration or have the company wound up.¹³⁶ The Pasmenco, Ansett and Pan administrators successfully applied on various occasions to extend the time limits for the major meeting.¹³⁷

Overseas law

2.67 Chapter 11 does not have prescribed time limits, other than an initial 120 days for the directors to develop and implement a reorganisation plan. The court may extend that period.

2.68 Recent amendments to the UK legislation have introduced various new timeframes:

- within eight weeks of the start of the administration, the administrator must make a statement outlining proposals to achieve the purpose of the administration
- within ten weeks of the administration's commencement, the initial creditors' meeting must be held
- the overall period of an administrator's term of office is up to one year.

2.69 Any of the above time periods can be extended by the court or by agreement of the creditors. Creditors' agreement requires the approval of each secured creditor and more than 50% of the company's unsecured creditors by value.

¹³³ The court may terminate a deed of company arrangement if satisfied that the information given by the administrator to the creditors was false or misleading in a material respect or was otherwise defective: s 445D(1).

¹³⁴ ss 439A(6) (major meeting), 444B(2)(b) (execution of deed).

¹³⁵ 447A.

¹³⁶ *Kantfield Pty Ltd v Plastamatic (Aust) Pty Ltd* (1994) 14 ACSR 687, *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139, 13 ACLC 885, *Deputy Commissioner of Taxation (Cth) v Pddam Pty Ltd* (1996) 19 ACSR 498, 14 ACLC 659, *Re Pan Pharmaceuticals Ltd* [2003] FCA 598 at [42].

¹³⁷ See, for instance, *Re Pan Pharmaceuticals Ltd* [2003] FCA 598. However, in *Re Ansett Australia Ltd and Others (all admin apptd)*; *Mentha and Another (as admins) v Sydney Airports Corporation Ltd* (2002) 41 ACSR 352, the court refused to exercise its discretion to extend time for executing the Ansett deed of company arrangement, ruling that the application was for a purpose other than to enable the administrators to finalise the drafting, preparation and execution of the deed.

Policy options

Extend current time limits

2.70 The Advisory Committee's *Corporate Voluntary Administration Report* recommended only incremental increases in the prescribed periods for holding the first and major creditors' meetings.¹³⁸

2.71 The following more significant extensions of the current time limits have been suggested:

- *first meeting*: 10 to 20 business days after the voluntary administration begins
- *personal liability for rented property*: the period for deciding whether to accept personal liability for rented property should be extended from 7 days to 14 days
- *major meeting*: convening period to end 3 months after the voluntary administration begins.

2.72 On one view, these extended prescribed times would:

- assist the administrators of large and complex enterprises to conduct proper investigations and develop alternatives for the future of the company before the major meeting of creditors
- be likely to benefit creditors, as they would allow the administrator to seek a greater return to creditors than would be available on a winding up.

Give the court an express power to alter current time limits

2.73 One submission has argued that the courts should have express statutory power to extend any of those time periods. Any application by the administrator could be *ex parte*, with any creditor having a right at any time to challenge the timetable in court. This power need not be limited to large and complex enterprises, though a company's size and complexity could be a relevant consideration for the court in deciding any application.

Give creditors at the first meeting the power to extend the convening period

2.74 An alternative, or additional, possibility would be to allow the creditors, by resolution at their first meeting, to vary the period for holding the major meeting. This power could be open-ended or subject to a maximum time limit, say, three months. An administrator who wished to have a further extension could either get a further resolution of the creditors or apply to the court.

Consequence of extending the time limits

2.75 The creditors at the major meeting can decide between entering into a deed of company arrangement, having the company wound up or ending the administration and returning the company to the control of its board of directors.¹³⁹ They do not have this power at the first meeting.¹⁴⁰ To materially extend the permissible time for conducting

¹³⁸ Recommendations 2 (first meeting increased from 5 to 8 business days), 6 (major meeting increased from 21 days to 25 business days).

¹³⁹ s 439C.

¹⁴⁰ s 436E.

the major meeting may result in the right of creditors to make this choice being considerably postponed.

2.76 One policy option, if the time limits were extended, would be to give creditors at their first meeting the power to resolve that the company be wound up.

Notifying pre-commencement creditors

The issue

2.77 Should the law be amended to reduce the cost of sending information to pre-commencement creditors of large and complex enterprises?

Current law

2.78 Currently, an administrator must give written notice of the major meeting of creditors 'to as many of the company's creditors as reasonably practicable' and cause notice of the meeting to be published.¹⁴¹ The administrator must send to creditors with this notice:

- a report by the administrator about the company's business, property, affairs and financial circumstances
- a statement setting out the administrator's opinion about the appropriate course of action for dealing with the company's affairs
- if that course of action is a deed of company arrangement, a statement setting out details of the proposed deed,¹⁴² and
- a proxy form.¹⁴³

These documents must be given to creditors personally, by prepaid post, by fax or through a document exchange.¹⁴⁴

2.79 In *Re Ansett Australia Ltd and Others (all admin apptd) and Mentha* (2002) 40 ACSR 419, the administrator sought a direction that the statutory requirement to give 'written notice of the meeting to as many of the company's creditors as reasonably practicable' could be satisfied through newspaper advertisements that included a reference to a website and a telephone contact, given the considerable cost of a complete mail-out (\$28 million in this case).¹⁴⁵ Goldberg J rejected this application. His Honour considered that, while expense may be relevant, the primary consideration

¹⁴¹ s 439A(3).

¹⁴² s 439A(4).

¹⁴³ Corporations Regulations reg 5.6.31. Corporations Regulations regs 5.6.12 to 5.6.36A apply to the convening and conduct of, and voting at, voluntary administration meetings by virtue of reg 5.6.11(2).
¹⁴⁴ Corporations Regulations reg 5.6.12(2).

¹⁴⁵ This method would not constitute 'written notification', even though s 9 defines 'notice' as including 'a circular and an advertisement'. The requirement is for a notice to be given (s 439A(3)(a)), which is in addition to, and different from, publication, which is provided for separately (s 439A(3)(b)).

remained that creditors be notified of the convening of a meeting and their right to receive all the information.¹⁴⁶

2.80 However, his Honour in this case exercised the court's discretionary powers¹⁴⁷ to relieve the administrator of the obligation to send all supporting documents to creditors. Instead, the court directed that the administrator post a one page written notice to all contactable creditors, with reference in that notice to where supporting documents could be obtained on the administrator's website. In addition, the administrator had to publish large advertisements in Australian newspapers and establish a toll-free telephone number that creditors could ring to obtain, free of charge, a copy of the documents.

Policy options

2.81 Possible alternative approaches include:

- leave the method for notifying creditors to the discretion of the court, as under the current law, or
- stipulate in the legislation when administrators may use websites and hotlines, rather than physical delivery, to provide relevant information to creditors.

Lending to a company under administration

The issue

2.82 Obtaining financial accommodation quickly may be crucial to the prospects of successfully restructuring companies under administration. However, it may be difficult for companies to obtain loan funds once in administration, given uncertainty under the current law about:

- the personal liability of the administrator to the lender
- the indemnification rights of the administrator
- the relative position of the lender vis-à-vis other creditors.

Should the law on these points be clarified and, if so, in what manner?

Current law

2.83 The position of lenders can best be understood by comparing them with persons who provide services, goods or property to a company under administration.

¹⁴⁶ His Honour held that the words 'as reasonably practicable' refer to the range of creditors to whom notice is to be given, not the manner of giving that notice. See further Leon Zwier, 'Ansett Administration Court-Approved Websites' November 2002 *Law Institute Journal* 46.

¹⁴⁷ s 447A.

Services goods or property: personal liability of the administrator, with indemnification rights

2.84 Administrators are personally liable for debts they incur on behalf of companies under administration in relation to services, goods or property.¹⁴⁸ The Advisory Committee's *Corporate Voluntary Administration Report* recommended that administrators should continue to be personally liable for debts incurred in the performance of any of their functions or powers.¹⁴⁹

2.85 The administrator has a right to an indemnity out of the assets of the company to cover this liability¹⁵⁰ and a lien to secure this indemnity right.¹⁵¹ This indemnity has priority over all the company's unsecured debts and some debts secured by a floating charge.¹⁵² Issues arising from this indemnity right are further discussed at paras 2.121–2.126.

2.86 Given that the creditor is protected through the personal liability of the administrator, with indemnification rights, the creditor may not be particularly concerned about its relative position vis-à-vis other unsecured creditors.

Funds borrowed: no personal liability of the administrator (or indemnification rights)

2.87 The provision that imposes personal liability on an administrator¹⁵³ does not cover funds borrowed. The *SEESA case*¹⁵⁴ held that lending money does not constitute rendering services to the company under that provision. Given this, the administrator is not personally liable for any funds borrowed on behalf of the company under administration. In consequence, there are no indemnification rights.

2.88 In the absence of the administrator's personal liability and indemnification rights, the lender's rights depend solely on the lender's relative position vis-à-vis other creditors. In this respect, a distinction needs to be drawn between the funds borrowed (the capital) and the interest due on those funds.

2.89 *Capital.* An administrator can, as agent of the company, grant a lender a first charge over any unencumbered property of the company.¹⁵⁵ Similarly, a person who already holds security over company property may agree to a lender having a higher priority over any funds that may be realised from any subsequent sale of that property. Any post-commencement priority arrangements are not subject to the deed of company arrangement, as a deed only applies to pre-commencement debts.

2.90 By contrast, anyone who lends money to a company under VA on an unsecured basis has no priority for repayment of the capital over other pre- or post-commencement unsecured creditors, unless the court orders otherwise (as occurred in the *SEESA case*, where the court gave the creditor a limited right of recovery against the administrator up to the value of the company's assets). This interpretation, if correct, would strongly discourage banks and other financial institutions from providing overdraft or other lending facilities to a company under

¹⁴⁸ ss 443A, 443B, 443BA.

¹⁴⁹ Recommendation 39.

¹⁵⁰ s 443D.

¹⁵¹ s 443F.

¹⁵² s 443E.

¹⁵³ s 443A.

¹⁵⁴ (2002) 40 ACSR 389.

¹⁵⁵ ss 437A(1)(d), 437B.

administration, even where the administrator uses the funds to obtain services, buy goods or lease property.

2.91 *Interest.* The interest charged on the capital would be in the same position as the capital unless it could be characterised as an expense ‘properly incurred by a relevant authority ... in carrying on the company’s business’.¹⁵⁶ This interpretation would give the interest owed to these lenders priority over all pre-administration unsecured debt (for services, goods, property or loans).

Overseas law

2.92 The North American jurisdictions do not substitute an external administrator for the company’s management. Instead, the board of directors of a company in Chapter 11 (the company being known as a ‘debtor in possession’ (DIP)) remains in control. These jurisdictions therefore have no notion of an administrator being personally liable for post-appointment debts of the company, with indemnification rights. Instead, all post-appointment creditors, including lenders, must look to their position vis-à-vis other creditors to determine their level of protection.

US

2.93 There are specific statutory rules governing DIP loan financing. The Bankruptcy Code distinguishes between loans for ordinary course and non-ordinary course purposes, the former generally referring to day-to-day business affairs. The DIP may incur ordinary course debt without prior court approval (though the court can order that a DIP not incur such debt). The DIP may also incur non-ordinary course unsecured debt with court approval. In either case, the debt is an administrative expense and takes priority over unsecured pre-commencement debts.

2.94 Where a DIP cannot obtain an unsecured loan because this priority would not be sufficiently attractive for the lender, the court has power, after notice to creditors and a hearing, to authorise a loan secured over any unencumbered assets of the DIP or even one that ranks equally with, or has priority over, the claims of existing secured creditors, provided that those secured creditors receive adequate protection through a ‘cushion of collateral’ (being the excess of the value of the security over the amount owed) in any affected security.

Canada

2.95 Canadian courts have been prepared to give priority to new financing, even over the claims of existing secured, as well as unsecured, creditors on a ‘balance-of-prejudices’ test. Under this test, the losses that the company and other affected persons, including employees, will sustain if the financing is not approved are weighed against the possible losses to existing secured creditors under a super-priority financing.

¹⁵⁶ s 556(1)(a). ‘Relevant authority’ includes an administrator of a company: s 556(2). Finkelstein J in *In the Matter of Pasmenco Ltd (Administrators Appointed)* expressed the view that interest could be characterized as a properly incurred expense: see his discussions with counsel at Transcript 10 October 2001 P-7.

2.96 A Canadian Joint Task Force¹⁵⁷ has proposed replacing the current court discretion with a detailed statutory regime to regulate interim financing to the company under administration.

2.97 Under these proposals, the Canadian courts could:

- approve interim financing, taking into account a number of non-exhaustive statutory guiding principles. These link the granting of such financing to the proper governance of the corporation during the period of administration (taking into account that the board of directors remains in office) and whether the possibility of the loan enhancing the prospects for rehabilitating the company would overcome any material prejudice to existing creditors as a result of the company's continued operations
- provide a form of secured super-priority for these loans where it is in the interests of creditors generally that the company be funded for a limited period to see if its rehabilitation is possible. Existing affected secured creditors could object before the court makes this order.

2.98 *Shared liquid-asset collateral proposal.* A Canadian body has put forward another possible approach to financing during the course of an administration.¹⁵⁸

2.99 Under this model, new lenders and existing secured lenders would share a first-ranking priority over the already secured liquid assets of the company, proportionate to the amounts they have respectively lent. This security sharing would recognise the relative contributions of both existing creditors and the new lender to the value of the company, while removing the ability of existing secured creditors to, in effect, 'free-ride' on the new funds contributed by the new lender. Proponents of this model argue that this security sharing arrangement may be less detrimental to initial lending decisions and credit availability than giving an outright super-priority to new lenders.

Policy options

2.100 There is a range of policy options to deal with the three inter-related elements of financing during the period that a company is under administration.

A. Personal liability of the administrator to the lender

The administrator could be:

- (i) automatically personally liable (in the same manner as for services, goods and property), or
- (ii) personally liable, unless exempted by agreement between the lender and the administrator, or
- (iii) personally liable up to the value of the company's assets

¹⁵⁷ *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendations 1–11.

¹⁵⁸ Corporate Law Policy Development, Industry Canada, *Efficiency and Fairness in Business Insolvencies* (January 2001), pp 45–46.

- (iv) not personally liable

to repay money lent to the company during the administration period.

B. Indemnification rights of the administrator if personal liability applies

The indemnity rights of the administrator could be:

- (i) superior to all other claims, secured or unsecured, or
- (ii) the same as for indemnification rights regarding services, goods or property.¹⁵⁹
(Issues arising from these indemnity rights are further discussed at paras 2.121–2.126.)

C. The relative position of the lender vis-à-vis the other creditors

Possibilities include the lender having:

- (i) a super-priority over all other creditors, whether secured or unsecured, or
- (ii) the same priority over other unsecured creditors as for services, goods or property,¹⁶⁰ or
- (iii) a shared priority with existing lenders, as per the shared liquid-asset collateral proposal.

Voting

The issues

2.101 Should the voting requirement of majority by number of creditors as well as majority by value be retained?

2.102 If so, should administrators continue to have a casting vote at creditors' meetings where the vote of the majority by value is contrary to the majority by number? Should administrators be required to give reasons for the exercise of any casting vote?

The Harmer Report

2.103 The Harmer Report recommended¹⁶¹ that:

- approval of a resolution by a formal poll of creditors should require a majority by both number and value
- any deadlock between number and value should be resolved by the court.

¹⁵⁹ ss 443E, 443F.

¹⁶⁰ However, it would need to be clarified whether this is a first priority under s 556(1)(a) or a lower priority under s 556(1)(c).

¹⁶¹ paras 569–579.

Current law

2.104 A resolution of creditors by poll is carried if there is a majority by number and value of creditors.¹⁶² However, if the vote of the majority by number differs from the vote of the majority by value, the chairman of the meeting, usually the administrator, may exercise a casting vote.¹⁶³ In so doing, the administrator is not obliged to prefer the view of the majority by value to the majority by number,¹⁶⁴ though the administrator has a duty to make proper inquiries or obtain appropriate legal advice about the implications of the vote.¹⁶⁵ The administrator may even exercise the casting vote on motions for his or her removal, provided that the administrator is not acting through self-interest or in an unfairly prejudicial manner and has made adequate disclosure.¹⁶⁶ Creditors can challenge the exercise of the casting vote in court.¹⁶⁷

Policy options

Majority by value to predominate

2.105 One option is to either abolish voting by number or adopt the principles that apply at shareholder meetings, whereby a vote by show of hands can be overridden by a subsequent poll, determined by value only, if demanded.¹⁶⁸

2.106 A Canadian Joint Task Force argues that voting by number be abolished, as it can artificially inflate the bargaining power of creditors with relatively small claims and could be abused by some ‘vulture investors’ who deliberately subdivide claims in an effort to gain a veto over the restructuring process.¹⁶⁹

2.107 The contrary argument, put forward in the Harmer Report, is that the dual number and value requirement would ensure that a major creditor has some influence, but cannot have resolutions passed without sufficient support from the creditors overall.¹⁷⁰

2.108 The Advisory Committee’s *Corporate Voluntary Administration Report* favoured retention of the current dual number and value requirement.¹⁷¹

Options if the dual number and value voting requirement is retained

2.109 If the dual number and value requirement is retained, what should be the outcome where the vote of the majority by number is contrary to the majority by value? The options include:

- retain the administrator’s casting vote in all circumstances

¹⁶² Corporations Regulations reg 5.6.21(2), (3). In *Re Ansett Australia Ltd (admin apptd)*; *Rappas v Ansett Australia Ltd (admin apptd)* (2001) 39 ACSR 296 and *Re Pasmenco Ltd (subject to deed of company arrangement)*; *Colley v Pasmenco Ltd* (2003) 45 ACSR 1, the court used s 447A to have various union officials appointed as the employees’ attorneys.

¹⁶³ Corporations Regulations reg 5.6.21(4).

¹⁶⁴ *Young v Sherman* (2001) 40 ACSR 12.

¹⁶⁵ *Cresvale Far East Ltd (in liq) v Cresvale Securities Ltd* (2001) 37 ACSR 394.

¹⁶⁶ *Young v Sherman* (2001) 40 ACSR 12.

¹⁶⁷ ss 600B, 600C.

¹⁶⁸ Cf Part 2G.2 Div 7.

¹⁶⁹ *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendation 58.

¹⁷⁰ para 574.

¹⁷¹ Recommendation 13.

- retain the administrator's casting vote except on motions concerning the administrator's continuing appointment or remuneration
- abolish the administrator's casting vote.

2.110 The Advisory Committee's *Corporate Voluntary Administration Report* favoured retaining the administrator's casting vote in all circumstances.¹⁷² Likewise, it has been submitted to the Advisory Committee that it should be unambiguously clear that an administrator should have a casting vote wherever there is a deadlock. However, the administrator should be required to give reasons for the manner in which a casting vote was exercised.

2.111 If either the second or third option in para 2.109 is adopted, deadlocks may arise. These could be resolved in one of the following ways:

- give priority to the vote of the majority by value (thereby effectively making voting by number irrelevant), or
- give the court power to resolve any deadlock between number and value (the Harmer approach), or
- provide that any motion will fail unless it obtains a majority by both value and number. This would ensure that creditors by value [number] could not be bound by the vote of creditors by number [value]. However, it would create a significant veto power. For instance, a large number of small unsecured creditors could veto a proposal put forward by a smaller number of large secured creditors.

Any of these three ways of resolving deadlocks would require the early determination of the value of contingent claims. This requirement could unduly slow down the administration in its early stages.

Remuneration of administrator

The issue

2.112 Should the administrator's remuneration be able to be fixed at a time earlier than the major meeting and, if so, by whom and with what rights of appeal?

The Harmer Report

2.113 The Harmer Report recommended that the administrator's remuneration be fixed by the creditors at the major meeting of creditors. The court would have power to fix the remuneration if either the remuneration is not determined by the creditors at that meeting or the administrator or a creditor is dissatisfied with the amount of the remuneration fixed by creditors at the meeting.¹⁷³

¹⁷² Recommendation 13.

¹⁷³ para 114.

The current law

2.114 Creditors may fix an administrator's remuneration by resolution at the major meeting called by the administrator to consider the company's affairs or at any later meeting called to vary a deed of company arrangement.¹⁷⁴ The court can review the remuneration so fixed and confirm, increase or reduce it.¹⁷⁵ The court may also itself fix the remuneration if the creditors have not done so at either of those meetings.¹⁷⁶

2.115 A court may lack the express power to fix the remuneration until the creditors' meeting has taken place. In *Re Ansett Australia Ltd and Others (all admin apptd) and Mentha* (2002) 40 ACSR 409, Goldberg J said that 'although the matter was not fully argued, it is arguable that the court is only entitled to fix the remuneration of the administrators pursuant to s 449E(1)(b) if there has been a meeting of creditors convened under s 439A and a resolution for the fixing of the administrators' remuneration has not been passed' (at 413). However, his Honour modified the law under s 447A to enable him to fix the administrators' remuneration and to enable the committee of creditors to fix the remuneration in the future.

2.116 In effect, if the major meeting of creditors is significantly delayed (as it may be in the administration of a large and complex enterprise), the administrator may receive no remuneration unless the remuneration can be fixed through an application to the court (and possibly even then only if the court modifies the law). In the meantime, the administrator may have committed substantial staff and resources to the administration. Administrators of large and complex enterprises may therefore incur considerable costs before the major meeting, particularly where that meeting has to be postponed for a considerable period while possible rehabilitation or liquidation options are developed.

Policy options

2.117 The Advisory Committee's *Corporate Voluntary Administration Report* recommended that administrators should be able to obtain approval of their fees by:

- agreement between the administrator and the committee of creditors
- resolution of creditors at any meeting where creditors have notice that remuneration is to be considered. The administrator should be able to convene a meeting of creditors for this specific purpose, or
- the court.¹⁷⁷

2.118 Various commentators support the committee of creditors having an express power to fix the remuneration by resolution, provided the committee members receive at least seven days' prior written notice of the amount of the remuneration claimed, together with details of how the amount claimed is comprised and calculated.

2.119 A precedent for allowing the committee of creditors to fix the administrator's remuneration is the power of a committee of inspection in a creditors' voluntary winding up to fix the remuneration of a liquidator.¹⁷⁸ A shareholder, creditor or the

¹⁷⁴ s 449E(1)(a).

¹⁷⁵ s 449E(2).

¹⁷⁶ s 449E(1)(b).

¹⁷⁷ Recommendation 38.

¹⁷⁸ s 499(3).

liquidator may apply to the court to review the remuneration so fixed.¹⁷⁹ Similarly, liquidators in court windings up can have their remuneration fixed by agreement with the committee of inspection or, if there is no committee of inspection or no agreement, by resolution of creditors or, if no such resolution is passed, by the court.¹⁸⁰

2.120 Two related issues are:

- should the administrator be required to provide a work in progress report with any fee proposal, on the argument that whoever is to approve the fees should be aware of this information
- should the court have the power, on the application of any creditor (under the first or second policy option in para 2.117) or the administrator (under the second policy option in para 2.117), to override either the agreement between the administrator and the committee of creditors or the resolution of creditors?

Administrator's indemnity rights

The issue

2.121 Do the statutory indemnity rights of administrators adequately cover them for any debts they incur in the course of an administration?

Current law

2.122 Administrators are personally liable for debts they incur on behalf of companies under administration in relation to services, goods or property.¹⁸¹

2.123 The administrator has a right to an indemnity out of the assets of the company to cover this liability¹⁸² and a lien to secure this right.¹⁸³ This right has priority over all the company's unsecured debts and some debts secured by a floating charge.¹⁸⁴

Problems arising from the current law

2.124 The level of protection given to administrators by their right to an indemnity out of the company's assets depends on the value of the company's assets exceeding the debts they have incurred. However, the actions of a receiver appointed by a substantial floating charge holder (refer paras 2.39 ff) could reduce the value of those assets to less than those previously incurred debts. An example would be a receiver

¹⁷⁹ s 504.

¹⁸⁰ s 473(3).

¹⁸¹ ss 443A, 443B, 443BA.

¹⁸² s 443D. The Advisory Committee's *Corporate Voluntary Administration Report* reviewed possible limitations on the administrator's right of indemnity arising from tortious liability (paras 6.66–6.69). The Report recommended (Recommendation 41) that an administrator's right of indemnity should cover any personal liabilities incurred by an administrator in the due performance of the administrator's duties, other than liabilities incurred in bad faith or negligently.

¹⁸³ s 443F.

¹⁸⁴ s 443E. However, Austin J in *Weston v Carling Constructions Pty Ltd (in prov liq)* (2000) 35 ACSR 100 held that, if a company goes into liquidation or provisional liquidation after it has been in administration and the liquidator or provisional liquidator recovers additional assets, the administrator's right of priority to payment out of those additional assets is subject to certain costs of the liquidation: s 556(1)(a), (b), (c).

who reduces or extinguishes the value to the company of a contract concerning a corporate asset by terminating that contract.

Policy options

2.125 One policy option is to restrict the ability of a floating charge holder to appoint a receiver. This is discussed in more detail at paras 2.39 ff.

2.126 Another policy option would be to require the floating charge holder to pay the administrator any difference in the reasonable value of any affected asset before and after the appointment of the receiver to the extent that the administrator's personal liability exceeds the available assets.

Voiding antecedent transactions

The issue

2.127 Should an administrator be entitled to apply to the court to void antecedent transactions?

The Harmer Report

2.128 The Harmer Report did not contemplate administrators having the right to apply to the court to void antecedent transactions.

2.129 The Harmer Report considered that deed administrators should have this right only if creditors specifically adopted the antecedent transaction provisions, as:

the voluntary administration procedure for companies is proposed with the principal objective of providing an efficient means for preserving commercial undertakings. In that environment it is considered to be undesirable to start with the premise that transactions with creditors who, presumably, will have an ongoing relationship with the business and whose continued support may be necessary for its survival should be susceptible to review under the antecedent transaction provisions.¹⁸⁵

Current Australian law

2.130 Liquidators, but not administrators or deed administrators, may apply to the court to void antecedent transactions.¹⁸⁶ However, the date for applying the 'relation back' powers for these transactions is deemed to be the date the company initially went into administration if the company subsequently goes into liquidation immediately after having been either in administration or subject to a deed of company arrangement.¹⁸⁷

2.131 It is also arguable that a provision could be included in the deed of company arrangement that those creditors who the administrator considers have been a party to voidable transactions shall be excluded from the distribution. However, affected

¹⁸⁵ para 116, note 188.

¹⁸⁶ s 588FF.

¹⁸⁷ ss 513A, 513C.

creditors could apply to the court to challenge that provision on the grounds of unfair prejudice.¹⁸⁸

US law

2.132 A company under Chapter 11 may commence recovery proceedings pursuant to the avoidance of antecedent transactions provisions of the Bankruptcy Code. The creditors' committee may also challenge voidable transactions. Antecedent transactions can also be attacked during the equivalent of the administration procedure in the UK and Canada.

Policy option

2.133 The Advisory Committee's *Corporate Voluntary Administration Report* did not specifically consider whether administrators should be entitled to apply to void antecedent transactions. However, from a practical point of view, the period during which administrators hold office may be far too short for them to take an action through to final judgment. Instead, the Report recommended that, where an application for winding up that has not been dismissed precedes a VA, the relation-back powers should extend back even further, namely, to the date of that initial winding up application.¹⁸⁹ A company could therefore not circumvent the effect of a winding up application in establishing the relevant 'relation-back' date for the voidable transaction provisions merely by going into VA.

Equity for debt swaps

The issues

2.134 Where it is proposed that creditors receive equity in exchange for their debt:

- should the deed administrator be exempt from the prospectus-type disclosure requirements in Part 6D.2, in the same manner that offers under schemes of arrangement are exempt
- should the deed administrator also be exempt from the requirement to provide creditors with a Product Disclosure Statement under Part 7.9
- should the acquisitions be exempt from the takeover provisions where the swap would result in a breach of the 20% takeover threshold?

2.135 Should any prospectus or product disclosure exemption only apply to equity for debt swaps not requiring the payment of further consideration?

¹⁸⁸ C Anderson & D Morrison, *Crutchfield's Corporate Voluntary Administration* (3rd Edition, Lawbook Co, 2003) at 43.

¹⁸⁹ Recommendation 52.

Prospectus disclosure

Current law

2.136 *Part 5.1 schemes of arrangement.* An offer of securities under a Part 5.1 scheme of arrangement is exempt from the disclosure requirements in Part 6D.2.¹⁹⁰ The rationale for this exemption is that the offerees will have already received a detailed court-approved explanatory statement under s 412. Also, the court must approve the final scheme.

2.137 *Voluntary administration.* There is no equivalent exemption from the disclosure requirements under Part 6D.2.¹⁹¹

Reform proposal

2.138 It has been proposed that offers of securities to creditors made under a Part 5.3A deed of company arrangement should also be exempt from disclosure under Part 6D.2, given:

- the similarity between the information provided to creditors about an offer of securities under a VA and that provided for an offer under schemes of arrangement¹⁹²
- the requirement that voluntary and deed administrators act at all times in the best interests of creditors
- the administrator's liability for any misleading or deceptive conduct, including knowingly false or misleading statements in the administrator's report, and
- the safeguards contained in ss 445D, 445G, 447A, 447E and 449B to ensure that unfairly prejudicial or discriminatory deeds are not propounded.

Without an exemption, an administrator may be reluctant to put forward an equity for debt funding proposal, given the due diligence obligations in having to prepare a full prospectus.

2.139 The Advisory Committee's *Corporate Voluntary Administration Report* recommended an exemption from the fundraising provisions for offers or invitations to creditors to exchange debt for equity under a deed of company arrangement,¹⁹³ noting that:

Those creditors are given information in the administrator's report [under s 439A(4)(a)]. However, the exemption should not apply to offers or invitations to other parties. The Committee acknowledges that this is a pragmatic solution to facilitate voluntary administrations, as the information

¹⁹⁰ s 708(17).

¹⁹¹ However, on one view, unless a deed of company arrangement provides for offers of securities to be made, a deed which provides for an issue of securities will not require disclosure under Part 6D.2 because there will be no 'offer' of the securities within the meaning of that term in Part 6D.2. In this regard, see *Re Bank of Adelaide* (1972) 22 SASR 481, *Re Wallace Dairy Co Ltd* [1980] VR 588 and *Re Crusader Ltd* [1996] 1 QdR 117.

¹⁹² Compare s 439A(3), (4) (VA) with s 412 (schemes of arrangement).

¹⁹³ Recommendation 58.

that creditors receive in an administrator's report is not necessarily equivalent to that which would be found in a prospectus.¹⁹⁴

2.140 On one view, any exemption should only apply to a straight equity for debt swap. The full fundraising disclosure provisions should remain if creditors are asked to contribute any further consideration for their shares.

Financial product disclosure

Current law

2.141 There is no exemption from the requirement to give a Product Disclosure Statement under s 1012B or s 1012C for any offer made under either Part 5.1 or Part 5.3A.

Policy options

2.142 One possibility is that, for the second and third reasons given under Prospectus disclosure, para 2.138 supra, there should be an exemption from the requirement to give a Product Disclosure Statement for an offer of a financial product made under either Part 5.1 or Part 5.3A.

2.143 Administrators are exempt from having to obtain an Australian financial services licence to provide services while performing functions, or exercising powers, in their capacity as administrator.¹⁹⁵ However, there are no exemptions from the Product Disclosure Statement requirements for offers and issues under deeds. Even if such an exemption were given, administrators would nevertheless remain liable for any misleading or deceptive conduct, including knowingly false or misleading statements in any information provided to creditors.

Effect of takeover provisions

Current law

2.144 *Part 5.1 scheme of arrangement.* By virtue of s 611 Item 17, schemes of arrangement that have been approved by the court are exempt from the takeover provisions. However, a scheme that affects shareholders, as well as creditors, must first be approved by both groups separately. Even if a scheme only affects creditors, shareholders can still object when the matter goes to court for approval. In summary, shareholders can either veto a scheme or request that the court refuse it final approval.

2.145 *Voluntary administration.* Deeds of company arrangement are not exempt from the takeover provisions. An administrator could initiate a takeover bid or seek an ordinary resolution of shareholders under s 611 Item 7 to approve an otherwise prohibited acquisition. In either case, shareholders have an effective right of veto over the restructuring. An administrator can seek to avoid this consequence by applying to ASIC for an exemption from the takeover provisions¹⁹⁶ and, if refused, can apply to the Takeovers Panel.¹⁹⁷

¹⁹⁴ para 9.21.

¹⁹⁵ s 911A(2)(f)(v), (vi).

¹⁹⁶ s 655A.

¹⁹⁷ s 656A.

2.146 *The Pasminco VA*. In this case, the administrator proposed an arrangement whereby the listed company under administration would issue a large number of shares to its creditors, who thereafter would have approximately 99% of the issued shares. The existing shareholders, whose current shares, the administrator contended, were close to being valueless, would remain as shareholders, primarily to satisfy the ASX shareholding spread requirement for listed entities. Those shareholders might receive some minimal return in the future if the financial fortunes of the listed company revived.

2.147 The creditors receiving the shares in the equity for debt swap would enter into standstill agreements controlling the disposal of their shares in the ‘workout’ period, which may last for a number of years. In consequence, each creditor would have a relevant interest in the shares of each other creditor. The result would be that the relevant interest of each of the creditors would cross the 20% threshold, thereby activating the takeover bid requirements.

2.148 The Pasminco administrators requested ASIC to give an exemption from the takeover requirements. Without relief from the takeover provisions, the equity for debt swap would be a prohibited acquisition, unless the existing shareholders gave prior approval.¹⁹⁸ ASIC did not grant that exemption. The administrators then went to the Takeovers Panel, which, in a two to one decision in *Re Pasminco Ltd* (2002) 41 ACSR 511, set aside the ASIC decision and granted a conditional exemption from the takeover provisions.

2.149 The Panel majority accepted that the purpose of the takeover provisions is to protect the interests of shareholders. However, where the shares in the company have no value, the interests of those shareholders do not require protection. It would be anomalous for those shareholders to have an effective right of veto over creditors.

2.150 The dissenting Panel member did not support granting relief from the takeover provisions in this case, arguing that:

- there were other routes available to the administrators to reconstruct Pasma Limited that would not involve altering the law or require the Panel’s involvement. One alternative was reconstruction by way of a creditors’ Part 5.1 scheme of arrangement
- the listed shell of Pasma and its spread of shareholders had an intrinsic value, which shareholders should receive if creditors wanted to use that shell and the shareholder spread, and
- the benefits to be gained by adopting the route proposed by the administrators were too uncertain and marginal to warrant the relief.

2.151 The majority Panel members in that case made it clear that they were not seeking to set a precedent in granting the exemption. A differently constituted Panel could in future reach a contrary conclusion on a similar set of facts.

¹⁹⁸ s 611 Item 7.

Policy Option 1: retain the current law

2.152 Under this option, administrators would continue to depend on the approval of shareholders, ASIC or the Takeovers Panel for effecting any equity for debt swap that would otherwise breach the takeover provisions.

Policy Option 2: extend the exemption from the takeover provisions that applies to schemes of arrangement (s 611 Item 17) to voluntary administrations

2.153 Consideration of this policy option must take into account some material differences between Part 5.1 and Part 5.3A.

2.154 A Part 5.1 scheme of arrangement is subject to shareholder approval (under a members' scheme) and court approval (under a creditors' and/or members' scheme). Any adversely affected party can object when court approval is sought, even under a creditors' scheme.

2.155 By contrast, shareholders do not vote in a VA, nor is court approval a prerequisite for entering into deeds of company arrangement. The VA provisions therefore have no equivalent of the procedural protections that apply under schemes of arrangement.

2.156 The Advisory Committee's *Corporate Voluntary Administration Report* considered that there should be no equivalent in Part 5.3A of the Part 5.1 exemption from the takeover provisions.¹⁹⁹ The Report gave three reasons.²⁰⁰

- Most companies that use the voluntary administration provisions are exempt from the takeover provisions, given their relatively small size.

One administrator has since argued that many companies under administration will not be exempt from the takeover provisions.

- Existing shares in a company under administration may still have an intrinsic underlying value for shareholders, given that the prerequisite test for entering into a VA, namely actual or likely insolvency, is a cashflow test,²⁰¹ rather than a balance sheet liabilities over assets test. For companies that retain an excess of assets over liabilities, the control premium issue is still relevant.

One administrator has since argued that the control premium issue can be avoided by requiring as a condition of exercising the takeover exception that the administrator declares that he or she is satisfied to a requisite level that the relevant shares have no value because the company has an excess of liabilities over assets. This concept is already used in a taxation context, where liquidators of a company are given power to determine that the shares in the company have no value.

- In appropriate circumstances, ASIC can modify the takeover provisions for larger companies, while still ensuring that shareholders are not unduly deprived of reasonable information or an opportunity to consider a proposal under which control of the company would change.

¹⁹⁹ Recommendation 57.

²⁰⁰ para 9.9.

²⁰¹ s 95A.

One administrator has since argued that the takeovers provisions should not apply where the person administering the company declares that the shares are ‘intrinsicly worthless’. In these circumstances, there should be no requirement for ASIC approval.

2.157 On one view, if the takeover exemption were extended to VAs, shareholders who believed that their interests would be adversely affected under a deed of company arrangement could apply to the court to have the deed terminated.²⁰² They would need to establish their standing as an interested person on the basis that their pecuniary or financial interests were being affected by dilution of their holdings. Also, shareholders could apply to the court for ‘such order as it thinks just’ if the administrator or deed administrator has done, or proposes to do, an act which is prejudicial to all or some of the company’s shareholders.²⁰³

Policy Option 3: give the court an express power to exempt a voluntary administration arrangement from the takeover provisions

2.158 No court has been called on to determine whether it has power under s 447A to exempt share acquisitions under a voluntary administration from the takeover provisions. The administrators in the Pasminco voluntary administration did not take this matter to court.

2.159 In any event, it might be worthwhile for the legislation to deal with this matter expressly, rather than depend on s 447A.

2.160 One approach would be to give the courts a specific enabling and exemption power, having regard to the increasing rights of the creditors vis-à-vis the shareholders where the company is close to insolvency and the value of the shareholders’ interests is close to zero. A Canadian Joint Task Force has proposed that Canadian courts have this express exemption power, arguing that to allow shareholders whose equity has no material economic value to in effect veto a share issue that would benefit creditors ‘may give them significant leverage, which translates into an opportunity to extract hostage payments in return for their approval’.²⁰⁴

Ambit of the court’s powers to give directions

The issue

2.161 Should the court have power to approve business or commercial decisions by the administrator?

Current law

2.162 The court’s discretionary powers under the VA provisions²⁰⁵ are wide enough to permit the court to make orders in the future, rather than merely cure past defects or

²⁰² s 445D(1).

²⁰³ s 447E.

²⁰⁴ *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendation 61.

²⁰⁵ s 447D, as modified pursuant to s 447A.

remedy the consequences of some departure from the scheme of Part 5.3A.²⁰⁶ On a number of occasions during the Ansett administration, the administrators applied to the court for directions²⁰⁷ that it was proper for them to enter into an agreement or act on a commercial decision where they might otherwise be open to subsequent allegations of breach of duty.

2.163 In some cases (for instance, *MOU Application* (2001) 39 ACSR 355, *Sale of Sydney DTL* (2002) 41 ACSR 605), Goldberg J made protective orders, while in another instance (*Trade-on Application* (2002) 40 ACSR 433), His Honour declined to provide a protective direction.²⁰⁸

2.164 Goldberg J drew the distinction thus:

There must be something more than the making of a business or commercial decision before a court will give directions in relation to, or approving of, the decision. It may be a legal issue of substance or procedure, it may be an issue of power, propriety or reasonableness, but some issue of this nature is required to be raised. It is insufficient to attract an order giving directions that the liquidator or administrator has a feeling of apprehension or unease about the business decision made and wants reassurance. There must be some issue which arises in relation to the decision. A court should not give its imprimatur to a business decision simply to alleviate a liquidator's or administrator's unease. There must be an issue calling for the exercise of legal judgment.²⁰⁹

The court will act in an appropriate case, provided the administrators make full and fair disclosure.²¹⁰

2.165 In circumstances where the court is unwilling to make a protective direction, administrators may nevertheless receive some comfort in making their business or commercial decisions through the court's recognition that the 'structure of Part 5.3A contemplates that an administrator of a company may have to operate the business of a company under administration at a loss in order to further the objects of Part 5.3A found in s 435A'.²¹¹

Policy options

2.166 On one view, ensuring that the court has adequate powers to give protective directions in relation to business or commercial decisions is particularly important for large administrations, given the greater tendency for creditors in those administrations to have diverse interests. An administrator's commercial decisions may therefore benefit some creditors at the expense of others. The latter may threaten proceedings against the administrator for breach of fiduciary duty. Without protective orders, administrators may be unwilling to take the commercial risks necessary for companies to have any realistic prospect of rehabilitation.

²⁰⁶ *Australasian Memory Pty Ltd v Brien* (2000) 200 CLR 270 at 279.

²⁰⁷ Under s 447D, as modified pursuant to s 447A.

²⁰⁸ See further L Zwier and D Merkel, 'The scope of the court's supervisory jurisdiction under Part 5.3A: The Ansett experience' (2003) *Insolvency Law Journal* 27.

²⁰⁹ (2002) 40 ACSR 433 at 451. This is consistent with the approach adopted by the court in liquidation matters: *Re Spedley Securities* (1992) 9 ACSR 83 at 85.

²¹⁰ *Re Ansett Australia Ltd and Others* (all subject to deeds of company arrangement) and *Mentha and Another* (2002) 41 ACSR 605 at 616.

²¹¹ (2002) 40 ACSR 433 at 442.

2.167 A contrary argument is that it is not the appropriate role of the court to either make or endorse business or commercial decisions. At a minimum, courts may not have the necessary information, or commercial expertise, for this task.²¹² Also, to give them this power may result in administrators making applications to the court merely to avoid having to make these decisions themselves. In addition, an administrator, as an officer of the company, already has the protection of the business judgment rule,²¹³ though this does not extend to the statutory duty of good faith.²¹⁴

Set-off

The issue

2.168 Should the moratorium on the exercise of creditors' rights extend to a creditor (usually a financial institution) setting off debts owed to it by a company against any funds that it holds on the company's account?

Current law

2.169 Creditors can exercise rights of set-off in a VA.²¹⁵ A similar right of set-off applies in a winding up.²¹⁶

2.170 After the appointment of the Ansett administrators, a bank set off approximately \$50 million from the various Ansett credit accounts with the bank against debts owed by Ansett to the bank under various security documents. The \$50 million set-off included approximately \$7 million of post-appointment receipts.

Policy options

2.171 One submission has suggested that set-off rights should be subject to the moratorium in the same manner as other property rights. The current set-off provisions in effect give the set-off creditor a priority over all other creditors. Prohibiting set-offs would allow companies under administration to obtain the full benefit of the moratorium and ensure that all creditors are treated equally.

2.172 A contrary view is that set-off is already an established exception to the *pari passu* principle in a winding up. Arguably, the same exception should continue to apply to any corporate rehabilitation procedure. Also, financial providers would seek to design contracts to avoid the effect of any legislative changes that sought to subject set-off rights to the same moratorium as other property rights.

²¹² In *Re Mineral Securities Australia Ltd (in liq)* [1973] 2 NSWLR 207 at 232, Street CJ said: 'When the court is required to pronounce upon the commercial prudence of a transaction, it enters upon a slippery and uncertain field. Apart from the lawyer's disclaimer of expert qualifications in matters of business prudence, the very process of litigation and the necessary limitations upon the scope of admissible evidence restrict the available material to far less than is necessary for the making of a commercial decision'.

²¹³ s 180(2), s 9 definition of 'officer'.

²¹⁴ s 181.

²¹⁵ *Cinema Plus Ltd (admins apptd) v ANZ Banking Group Ltd* (2000) 35 ACSR 1.

²¹⁶ s 553C.

Administrator's access to information gathered by regulators

The issue

2.173 Should ASIC or any other regulator have the power to provide information to an administrator prior to any actual or contemplated proceedings by that administrator? If so, should this access be only for specific stated purposes?

Current law

2.174 An administrator has a duty to investigate the affairs of the company and consider possible courses of action.²¹⁷ In so doing, the administrator can require assistance from the directors and has rights of access to relevant documents.²¹⁸ The administrator must report any apparent misfeasance to ASIC.²¹⁹

2.175 ASIC may also obtain information and documents under its examination and other investigative powers. It may provide a copy of any record of examination and any related books to any lawyer who is carrying on, or contemplating in good faith, any proceeding in respect of a matter to which the examination relates.²²⁰ That information can only be used for the purpose of the proceedings²²¹ and subject to any other conditions that ASIC may impose.²²² In other circumstances, ASIC can give information to various stipulated agencies and persons, though an administrator is not included in that list.²²³

Pooling of assets and deeds of cross-guarantee in corporate groups

The issue

2.176 Should pooling be permitted in the administration of corporate groups and, if so, in what manner?

Current law

2.177 The Part 5.1 scheme of arrangement legislation has express provisions to permit the consolidation of meetings where the scheme involves multiple subsidiaries.

2.178 There is no equivalent under the VA provisions. An administrator dealing with a group of companies must generally ensure that separate meetings are held for each group company, separate minutes are taken and the creditors' committee of each company is separately constituted. However, it is possible to convene a joint meeting of the creditors of various corporate group companies that are under VA, provided the

²¹⁷ s 438A.

²¹⁸ ss 438B, 438C.

²¹⁹ s 438D.

²²⁰ ASIC Act s 25.

²²¹ ASIC Act s 25(2).

²²² ASIC Act ss 25(3), 26.

²²³ ASIC Act s 127.

creditors agree and only the creditors of each particular group company vote on any proposal for that company.²²⁴ The courts have also ruled that the VA provisions permit deeds of company arrangement binding two or more insolvent companies.²²⁵

2.179 Companies in a group can effectively pool their assets and liabilities by entering into cross-guarantees to cover each other's debts. However, this does not necessarily fully protect employee entitlements. The employees of each individual company in a group have a priority claim against their own company, but would only be ordinary unsecured creditors of the other companies in the group under any cross-guarantee. Employee entitlements are further discussed at paras 2.215–2.221, post.

Advisory Committee *Corporate Groups Report*

2.180 The Advisory Committee's *Corporate Groups Report* (May 2000) (available under *Final Reports* on the CAMAC Website www.camac.gov.au) recommended that administrators should be permitted to pool the administration of several companies, either where no creditor who attends the creditors' meetings votes against the proposal or the court otherwise approves.²²⁶

2.181 The Committee further recommended that the provisions regulating pooled administrations should specifically provide for:

- joint creditors' meetings, though creditors of a particular company should only be permitted to vote on matters that affect that company, subject to a court power to make orders to cover circumstances where the affairs of the companies in the pooled administration have become inextricably intermingled
- deeds of company arrangement that bind more than one company
- the variation, termination and avoidance of multi-company deeds of company arrangement.

Submissions and policy options

2.182 Since the *Corporate Groups Report*, it has been suggested to the Advisory Committee that a distinction should be drawn between companies that are and those that are not subject to a deed of cross-guarantee.²²⁷

Companies subject to deed of cross-guarantee

2.183 That submission proposes that, where a group of companies is subject to an ASIC-approved deed of cross guarantee, the assets and liabilities of those companies should be pooled at the discretion of the administrator or deed administrator without the need to obtain a court order.

²²⁴ In *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139, two related companies were in administration under the control of the same administrator. The administrator held the major meetings of the two companies simultaneously. The Court (at 147) approved that procedure, noting that the creditors had unanimously decided that the two meetings should be held simultaneously and that the chairman of the meeting was careful to point out that only the creditors of each particular company were entitled to vote on any proposal for that particular company.

²²⁵ *Mentha v GE Capital Ltd* (1997) 27 ACSR 696.

²²⁶ Recommendation 20.

²²⁷ Ferrier Hodgson.

2.184 The submission argues that:

- creditors deal with group companies subject to a deed of cross-guarantee on the basis that each member of the group is contingently liable for the debts and obligations of any other member of the group
- companies in a group subject to a deed of cross-guarantee disclose the existence and effect of the deed in their financial statements
- there is no reason why these outcomes should not simply continue in an administration.

Companies not subject to deed of cross-guarantee

2.185 For VAs not involving deeds of cross-guarantee, the submission does not favour the Advisory Committee's recommendation in its *Corporate Groups Report*. The submission argues that:

The position needs to be made certain immediately from the commencement of the voluntary administration. It would be unacceptable from the point of view of the voluntary administrator's indemnity that a subsequent decision by creditors could remove their ability to recover against all companies in the group.

2.186 Instead, the submission proposes that:

- a special resolution, rather than unanimous consent, of creditors should suffice to approve the pooling
- individual creditors should have a right to appeal to the court against a special resolution approving pooling²²⁸
- the court should have jurisdiction to confirm, set aside or modify a decision of the creditors to pool²²⁹
- in any event, pooling should apply automatically from the commencement of the administration (unless the administrator determines otherwise) until the confirming resolution of creditors fails or the court overturns the confirming resolution
- however, failure of a confirming resolution should not affect the administrator's right to an indemnity out of all of the assets of the group for liabilities incurred prior to the failure
- administrators should have a right to seek a pooling order from the court immediately from the commencement of the administration.

2.187 The submission further suggests that, failing adoption of the Advisory Committee's recommendation or the submission's suggested alternative, courts should at least have the power to order that the administrator of a number of group companies is entitled to be indemnified out of the property of all or some specified group companies for:

²²⁸ Cf s 510.

²²⁹ Cf s 510(4).

- the debts for which the administrator is liable under Division 9 Subdivision A or under a ‘remittance provision’,²³⁰ and
- the administrator’s remuneration.²³¹

2.188 The submission also contends that pooling should have the following consequences:

- only one meeting of creditors of all group companies should be required
- only one set of minutes for each of the first meeting and major meeting of creditors should be required to be lodged with ASIC, providing the minutes refer to all companies for which the meeting was held
- the administrator should have the option (but not the obligation) to propose a single deed of company arrangement for all or some pooled group companies
- the administrator’s or deed administrator’s indemnity, lien and priority rights should apply equally across all companies in the pooled group. These rights should be able to be modified or cancelled under a deed of company arrangement, but not while a company is in the initial administration period.

2.189 Another possibility is to require the administrator of pooled companies to prepare only a single report for the group.²³² However, where the administrator of companies in a group recommends that more than one deed of company arrangement be entered into, there should be a separate explanatory statement for each proposed deed.²³³

Implications of pooling for employees and other priority creditors

2.190 If pooling were permitted, should the priority creditors of one company in a pooled group, for instance the employees, retain their priority against the pooled assets of the whole group?

IpsO facto clauses

The issue

2.191 Should ipso facto clauses be rendered void or otherwise subject to some restriction?

The nature of ipso facto clauses

2.192 These are contractual clauses that have the effect of placing a company in default in circumstances short of insolvency or failure to repay, including, for instance, by reason of any ‘material adverse change’ in the company’s financial circumstances or entry into a VA (or other external administration procedure). Typical ipso facto clauses

²³⁰ Defined in s 443BA(2).

²³¹ This is fixed under s 449E.

²³² s 439A(4)(a).

²³³ s 439A(4)(c).

under bank loans provide that the bank may terminate its obligation to lend any further funds and could accelerate repayments of funds already lent, in the event of default.²³⁴

Harmer Report

2.193 The Harmer Report did not support ipso facto clauses. It recommended that the legislation should, unless the court otherwise orders, render void against a liquidator or administrator a provision in any agreement to the effect that, if a company commences to be wound up or becomes a company under administration:

- the agreement is terminated or may be terminated
- the agreement is modified, or
- property to which the agreement relates may be repossessed by a person other than the company.²³⁵

The Report pointed to a similar voiding provision in s 301 of the Bankruptcy Act.

Current law

2.194 There is no prohibition on enforcing ipso facto clauses.

1998 Advisory Committee Report

2.195 The *Corporate Voluntary Administration Report* summarised the arguments in submissions for and against the enforceability of ipso facto clauses.²³⁶

2.196 Submissions to that VA review that supported ipso facto clauses being rendered void put forward the following arguments.

- A voluntary administration is only of limited duration. To allow parties to terminate contracts or take other action merely because an administrator is appointed potentially prejudices all creditors and defeats the purpose of voluntary administration. Any party sufficiently aggrieved or prejudiced should be permitted to approach the court for an order, with the onus being on the party wishing to terminate the contract or take similar action.
- Failing to restrict contractual provisions that would enable a party to take certain action merely because the company appoints an administrator totally defeats the purpose of the law. Other contractual rights should be sufficient to protect the solvent party.

2.197 Some other respondents to that VA review put forward the following arguments for continuing to permit counterparties to enforce ipso facto clauses.

- A secured creditor must rely on a default under its security to take enforcement action. The default relied on is usually either the appointment of an administrator or a matter closely connected with the appointment.

²³⁴ Ipso facto clauses were upheld by the High Court in *Pan Foods Co Importers & Distributors Pty Ltd v ANZ Banking Group Ltd* (2000) 74 ALJR 791.

²³⁵ ALRC 45, vol 2, s AT10. See also vol 1, paras 703–705.

²³⁶ paras 4.11–4.12.

- A bank would not be able to terminate a facility agreement. It could be forced to continue to provide the company with funding. In the absence of other amendments, the administrator would not be personally liable to repay that funding, as it would not constitute services rendered, goods bought or property hired, leased, used or occupied (the transactions for which an administrator is personally liable).²³⁷

2.198 The Advisory Committee Report, on balance, considered that there should be no statutory restriction on enforcing ipso facto clauses.²³⁸

US law

2.199 The US Bankruptcy Code prevents counterparties from enforcing any contractual clauses that would place a company automatically in default if it filed a Chapter 11 petition.

Canadian proposal

2.200 A Canadian Joint Task Force has proposed a prohibition on enforcing ipso facto clauses, including any clauses that place a debtor company in a ‘materially adverse position’ or allow the counterparty to purchase property of the company for less than its current market value, merely by reason of going into administration.²³⁹

Submission

2.201 One view is that creditors should be prohibited from enforcing ipso facto clauses, unless the court grants leave in certain defined circumstances. The prohibition could be modelled on ss 301 ff of the *Bankruptcy Act 1966*.

Policy options

Retain the current law

2.202 The existence and operation of ipso facto clauses would remain a matter for the contracting parties.

Total prohibition on enforcing ipso facto clauses without court approval

2.203 This policy option may enable financially distressed companies to enter into earlier negotiations with their creditors on a possible VA or other form of reorganisation, given that those discussions could not automatically trigger defaults. This may assist in VAs being used more promptly, and thereby help stem the company’s further financial decline. It may help to stabilise the asset base of the company once it goes into VA and thereby assist that rehabilitation procedure.

²³⁷ s 443A.

²³⁸ Recommendation 21.

²³⁹ *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendations 33–35.

Limited prohibition on enforcing ipso facto clauses

2.204 Another approach would be to permit enforcement of those ipso facto clauses that do not destabilise the company's existing asset base, for instance, to permit a creditor to deny further credit during the administration period. Banks, or suppliers on credit, may be reluctant to enter into ongoing funding arrangements if they were obliged to lend funds, or continue to supply on credit, even after a VA has commenced.

Temporary freeze on enforcing ipso facto clauses

2.205 Under this option, the initiation of a VA could freeze the rights of contracting parties to enforce ipso facto clauses for a limited period (say, 21 days²⁴⁰). This temporary enforcement stay could give the administrator an opportunity to either honour such contracts or negotiate mutually agreed alternative terms with the counterparty.

Administrator's personal liability for overriding ipso facto clauses

2.206 Under this option, administrators could be given the power to override an ipso facto clause in a contract, provided that they accept personal liability (subject to indemnity rights) for any future debts incurred under that contract.²⁴¹

Assigning or terminating executory contracts

The issue

2.207 In what circumstances, if any, should an administrator have the power to assign or terminate the company's executory contracts (that is, contracts under which the company and/or the counterparty still have obligations to perform)?

Current law

2.208 An administrator cannot assign or terminate an executory contract to which the company is a party, except in accordance with its terms or with the prior consent of the contractual counterparty. It is an open question whether a deed administrator has this power.²⁴²

US law

2.209 The US Bankruptcy Code allows a company under Chapter 11 to assign an executory contract, regardless of its terms, provided that the contract is of a type that is generally assignable and the assignee gives appropriate assurances of future performance.

2.210 That company may also terminate a contract, regardless of its terms, with the counterparty having remedies in damages.

²⁴⁰ cf s 439A(5).

²⁴¹ This would be analogous to the provision imposing personal liability on administrators who choose to continue with rental arrangements after the first week of an administration: s 443B.

²⁴² See further G Hamilton, 'Deeds of Company Arrangement: The Prescribed Provisions' (1995) 3 *Insolvency Law Journal* 67 at 73–75.

Canada

2.211 A Canadian Joint Task Force has proposed rules similar to the US law detailing when a company can assign or terminate rights under executory contracts.²⁴³ These include:

- *assignment*: a power for the court to prohibit assignment of an executory contract where the proposed assignee is less creditworthy than the debtor was at the time of entering into the contract, unless reasonable assurances of payment have been provided²⁴⁴
- *termination*: a right of the debtor company to disclaim executory contracts (other than some financial contracts) with the prior written consent of the court-appointed monitor.²⁴⁵

Deed compliance with priority payments

The issue

2.212 Should the Corporations Act more specifically permit deeds of company arrangement to adopt an order of payments that differs from the order that would apply on a winding up? If so, should there be legislative guidelines for such variations?

Current law

2.213 There is no express provision that deals with this matter. However, a deed of company arrangement is taken to incorporate the prescribed provisions, one of which applies the priority provisions in s 556,²⁴⁶ except so far as the deed provides otherwise.²⁴⁷ On one view, this exception enables a deed to alter the s 556 priorities for payments under a deed. However, it is possible that deeds of company arrangement that depart from the winding up priorities could be set aside by the courts, on application by an affected party, as unfairly prejudicial to that party.²⁴⁸

Policy option

2.214 On one view, creditors should be permitted to approve deeds of company arrangement that depart from the winding up priorities, provided that it is in the overall interests of creditors. However, this would only apply to a deed of company arrangement, and would not affect creditors' rights in any subsequent winding up. It may be in the interests of certainty for administrators as well as creditors for the

²⁴³ *Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform* (March 2002), Recommendations 26–32.

²⁴⁴ *Id.*, Recommendation 32.

²⁴⁵ *Id.*, Recommendation 26.

²⁴⁶ Corp Reg 5.3A.06, Schedule 8A, cl 4. The Advisory Committee's *Corporate Voluntary Administration Report* (June 1998) recommended that the prescribed provision dealing with priority payments under a deed of company arrangement should incorporate all the priority provisions, not just s 556 (Recommendation 30).

²⁴⁷ s 444A(5).

²⁴⁸ C Anderson & D Morrison, *Crutchfield's Corporate Voluntary Administration* (3rd Edition, Lawbook Co, 2003) at 191.

legislation to set out guidelines that indicate when it is appropriate to depart from the winding up priorities.

Employee superannuation entitlements

Liability of administrator

2.215 Accrued rights under contracts of employment are enforceable against the company. Administrators are also personally liable if they adopt the contract. The principles for determining when adoption takes place are not clearly settled.²⁴⁹

2.216 The Advisory Committee's *Corporate Voluntary Administration Report* recommended that an administrator should not be taken to have adopted any employment contract unless the administrator does so expressly in writing. Even then, any adoption should only relate to entitlements that accrue during the period of the administration.²⁵⁰

Ranking of superannuation rights

2.217 Litigation has been undertaken in the Ansett administration to settle various questions concerning the position of superannuation in an administration, including whether it is a cost of the administration.

2.218 The Parliamentary Joint Statutory Committee on Corporations and Financial Services issued an Issues Paper in May 2003 (PJSC Issues Paper), which sought submissions on the issues concerning employee superannuation and other entitlements.²⁵¹ The Advisory Committee does not seek to replicate this review, given that issues concerning superannuation entitlements can apply equally to small or medium as well as to large and complex enterprises. The Advisory Committee's Final Report will not make any recommendations in this area.

Other employee entitlements

Current position

2.219 In September 2001, the Federal Government introduced the General Employee Entitlements Redundancy Scheme (GEERS). This is a government-funded administrative scheme. It does not substitute for an employer's obligations to pay all employee entitlements in full. When payments are made under GEERS, the Commonwealth is subrogated to the employees' rights as creditors of the company.

2.220 Unpaid wages, annual leave and long service leave and payment in lieu of notice are payable in full under GEERS, subject to a wage ceiling. Redundancy payments are capped at a prescribed number of weeks.

²⁴⁹ *Corporate Voluntary Administration Report* (June 1998), para 6.50.

²⁵⁰ Recommendation 40.

²⁵¹ paras 1.107ff.

Reform proposals

2.221 The PJSC Issues Paper discusses a proposal to change the Corporations Act to rank employee entitlements ahead of fixed securities.²⁵² The Advisory Committee does not seek to replicate this review, given that issues concerning employee entitlements can apply equally to small or medium as well as to large and complex enterprises. The Advisory Committee's Final Report will not make any recommendations in this area.

Solvency under the deed

The issue

2.222 Should there be some solvency prerequisite for a deed of company arrangement to be valid, for instance, that the company is solvent at the time of commencement of the deed?

Submission

2.223 It has been submitted to the Advisory Committee that a solvency prerequisite would reduce the incidence of phoenix companies.

Corporate governance issues

2.224 Initial submissions have raised various corporate governance issues.

Financial reporting requirements

2.225 It has been argued that Corporations Act Parts 2M.2 and 2M.3, which relate to a company's financial reporting requirements, should not apply to a company while it is under administration, as:

- these requirements are unnecessary, time-consuming and costly, given that shareholders may have no further economic interest in the company
- the s 439A report contains information about the company's affairs.

2.226 Are any changes necessary, given ASIC Interim Policy Statement 174 (June 2003), which provides exemptions and deferrals from the financial reporting obligations for companies under administration?

Annual general meeting

2.227 On one view, a company under administration should not be required to hold an AGM under s 250N, as:

- shareholders may have no further economic or other legitimate interest in the company's affairs if their shares are valueless under cash-flow and balance sheet tests

²⁵² paras 1.116–1.124.

- an AGM of such a company is simply an added (and, in the case of a large and complex enterprise, considerable) cost of the administration.

2.228 An argument for retaining an annual general meeting is that an administrator sends financial information only to creditors, not shareholders. Shareholders may have an interest in the outcome of an external administration, the effect of which may be to return some value to their shares.

2.229 Another approach would be to give an administrator a discretion not to hold an annual general meeting where, in the administrator's opinion, there is no remaining shareholder value.

2.230 ASIC Interim Policy Statement 174 (June 2003) sets out the circumstances where the Commission will extend the time for holding the annual general meeting of a company under administration.

Minimum number of directors

2.231 It has been argued that a company under administration should not be required to maintain a minimum number of (or indeed any) directors either under s 201A or pursuant to its constitution. The administrator has effective control over the company while it is under administration.²⁵³ Additionally, while a company is under administration, the powers of its directors and other officers are suspended.²⁵⁴ Also, the deed provides for who controls the company while it is under the deed.

2.232 In the Pasmenco administration, ASIC indicated that it would apply for a court order under s 459P to wind the company up if it did not have the statutory minimum number of directors. This was despite the fact that the creditors had approved the deeds that gave effective control of the company to the deed administrators and the creditors did not wish the company to be wound up.

Change of company name

2.233 It has been submitted that administrators or deed administrators should be able to change the name of the company without a special resolution of shareholders as required under s 157 if, in the administrator's opinion, it is desirable to do so in the interests of the administration.

2.234 It was argued that a change in company name may sometimes be an important step in reviving a company. This process could in some circumstances be hampered if shareholders can veto a change in the company's name.

Relationship between deed of company arrangement and company's constitution

2.235 On one view, an executed deed of company arrangement should, to the extent of any inconsistency, override the company's constitution. Creditors legitimately control the company and should not be bound by a contract between the company and its shareholders. For example, constitutional requirements relating to retirement of

²⁵³ s 437A.

²⁵⁴ s 437C.

directors, accounts and audit should be suspended while the company is under administration or subject to a deed of company arrangement.

Administrative issues

2.236 The following proposals have been put forward in initial submissions.

- Administrators should be given 48 hours to lodge a notification of appointment or cessation as an external administrator²⁵⁵ for large and complex administrations (currently, it is required to be lodged within 24 hours).

A contrary view is that the time required to complete and lodge a form need not differ between small and large administrations.

- The committee of creditors should be limited to the five largest unsecured creditors, plus two employee representatives. This is similar to the position under US Chapter 11. The current position potentially allows for too many creditor representatives and makes proceedings of the committee unwieldy. Also, no more than two representatives of each creditor should be entitled to attend creditors' committee meetings.

A contrary view is that any statutory limitation on the number of creditors on the committee of creditors or on the number of their representatives at any committee meeting may prove unduly inflexible in particular administrations.

- A company should be permitted to be a member of the committee of creditors. The statutory language suggests that only a natural person can be a member of the committee of creditors.²⁵⁶ However, to permit a company to be a member of that committee would allow different representatives of that company to attend meetings from time to time.

Other issues

Managed investment schemes

2.237 The *Corporate Voluntary Administration Report* (1998) paras 3.54–3.60 and Recommendation 20 dealt with voting by creditors who are also the owners of property that is pooled in a single enterprise forming part of the company's business. The Committee invites submissions on any other matter relevant to applying Part 5.3A to managed investment schemes.

Exchange listing

2.238 US listed entities subject to Chapter 11 can remain listed, and therefore their shares can be traded, on the stock exchange. By contrast, in Australia, trading in the securities of any entity going into VA would be suspended.

2.239 The Committee invites submissions on any aspect of this matter.

²⁵⁵ ASIC Form 505.

²⁵⁶ s 436G.

Invitation for submissions on Chapter 2

2.240 The Advisory Committee invites submissions on the following matters in so far as they apply to large and complex enterprises:

- any issue concerning these enterprises raised in this chapter
- any policy option concerning these enterprises raised in this chapter
- any other matter concerning these enterprises that is relevant to this chapter.

3 Creditors' schemes of arrangement

This chapter:

- *outlines the key features of creditors' schemes of arrangement*
- *compares the scheme of arrangement provisions with US Chapter 11 and the VA provisions*
- *discusses the use of schemes of arrangement for corporate rehabilitation and whether any legislative changes could be made to assist this process.*

Key features of creditors' schemes of arrangement

3.1 The main steps in entering into a Part 5.1 scheme of arrangement involving a compromise or arrangement between a company and its creditors are to:

- apply to the court to convene meetings of creditors or, where necessary, meetings of each class of creditors, to consider and vote on a compromise or arrangement (the scheme)²⁵⁷
- give ASIC 14 days' notice of the application and a reasonable opportunity to examine, and make submissions to the court on, the proposed scheme and the draft explanatory statement²⁵⁸
- if court approval is given, send creditors a notice convening the relevant creditors' meetings, together with the explanatory statement²⁵⁹
- obtain the stipulated majority of each class of creditors voting on the scheme, being at least 50% by number and 75% by value that vote at the meeting, of each class²⁶⁰
- return to court for final approval,²⁶¹ and
- lodge with ASIC a copy of the court order approving the scheme.²⁶²

3.2 The scheme operates by virtue of the final court order and binds all creditors of each approving class, including any members of that class who voted against it or failed to vote.

3.3 The court may restrain proceedings against the company where a scheme has been proposed.²⁶³

²⁵⁷ s 411(1).

²⁵⁸ ss 411(2), (3), 412(7).

²⁵⁹ s 412.

²⁶⁰ s 411(4).

²⁶¹ s 411(6).

²⁶² s 411(10).

²⁶³ s 411(16).

3.4 Where a scheme involves transferring the whole or part of the undertaking, the property or the shares of one company to another company, the court may make various facilitative orders to achieve this end.²⁶⁴

3.5 There are also special provisions to allow for consolidated meetings of creditors of a holding company and its wholly owned subsidiaries where it is proposed that the subsidiary's assets be transferred to the holding company.²⁶⁵

Comparison of creditors' schemes of arrangement with VA

3.6 Creditors' schemes of arrangement, like voluntary administrations, can be used to create an enforceable agreement that modifies the legal rights of secured and unsecured creditors against the company. That agreement may also involve some restructuring of the company's finances or its equity base.

3.7 The procedures for creditors' schemes of arrangement and voluntary administrations differ considerably. The following table, which expands on that in *Re Pasmenco Ltd* (2002) 41 ACSR 511, sets out these differences.

	Creditors' Scheme of Arrangement	VA
Prerequisite for commencing procedure	None.	Insolvency or risk of insolvency.
Can the directors commence the procedure	Yes.	Yes.
Who controls the company during the procedure	The directors.	An external administrator.
Personal liability of directors for any insolvent trading during the procedure	Yes.	No.
Court	Orders creditors' meetings and approves scheme. Public interest criteria for approving schemes. ²⁶⁶	No automatic role, however parties and other interested persons may apply to the court for intervention. No need for public interest criteria.
ASIC	Must be given draft scheme and explanatory statement and may address the court.	No role, unless on review of deed.
Information	Detailed explanatory statement containing all of the information known to the company that is material to a decision whether to approve the scheme and including copies of statutory accounts and a report as to affairs.	Report by the administrator about the company's business, property, affairs and financial circumstances and a recommendation about what is to be done. The report must be compiled quickly, in about three weeks, unless the court extends the time. In consequence, the report is often less detailed than for schemes.
Moratorium on claims against the company	Moratorium prior to final approval of scheme on application to court, but only for proceedings on foot at the time of that application.	Automatic moratorium once procedure commenced (with some exceptions).
Moratorium on directors' personal guarantees	No.	Yes, unless the court permits enforcement of the guarantee.

²⁶⁴ s 413.

²⁶⁵ s 411(1A), (1B), (1C).

²⁶⁶ These public interest criteria are outlined and analysed in S Atkins, 'The jurisprudence arising from judicial review of schemes of arrangement' (2003) 11 *Insolvency Law Journal* 18. See also I Renard and J Santamaria, *Takeovers and Reconstructions in Australia* (loose leaf, Butterworths) paras [1521]–[1523].

	Creditors' Scheme of Arrangement	VA
Method of approval	Meetings of each class of creditors. Each secured creditor may form a separate class.	One meeting of all creditors.
Majority	50% by number, and 75% by value, that vote at the meeting of each class.	50% majority by number and by value of the creditors, voting at a single meeting.
Discrimination between creditors	Not permitted. The principle of equality applies.	The creditors can approve a deed that discriminates against particular creditors.
Binding secured creditors	Yes, for any class that approves.	Yes, for any secured creditor that agrees or if the court so orders.
Shareholders	No role, but may appear as person interested when court orders creditors' meetings and approves scheme. Court may take their interests into consideration.	No role, unless they seek review of deed (for example where there is a prospect of an insolvent company trading out of its insolvency). They are bound by the deed.
Special provision for corporate groups	Yes—consolidation of meetings where a scheme involves multiple subsidiaries.	No.
Can be used for reconstruction	Yes.	Yes.
Reconstruction provisions	Yes—section 413.	No.
Assignment of liabilities	Yes.	No, other than through novation.
Acquisitions excluded from takeover provisions	Yes—Item 17 of s 611.	No.
Fundraising disclosure exemption	Yes—s 708(17).	No.
Product disclosure statement exemption	No.	No.

Use of schemes of arrangement for corporate rehabilitations

Similarities with Chapter 11

3.8 Companies in financial difficulties in Australia can use creditors' schemes of arrangement in a manner similar to companies under US Chapter 11.

3.9 The key similarities are that:

- both procedures can be commenced without the company being insolvent or likely to become insolvent
- the board of directors remains in control, and
- creditors' rights can be frozen. Initiation of a Chapter 11 automatically freezes these rights. By comparison, a company can achieve a moratorium on creditors' rights while a creditors' scheme of arrangement is in preparation by applying to the court to restrain any further action on existing proceedings against the company until such time as the scheme has been approved. The court may act where a scheme 'has been proposed between the [company] and its creditors or any class of them', notwithstanding that no meeting of creditors has yet taken place.²⁶⁷ However, the ambit of the court's power to make this order is not yet settled. Another alternative is for a company to apply to the court for the appointment of a

²⁶⁷ s 411(16).

provisional liquidator to control the company during this preparation period.²⁶⁸ Appointment of a provisional liquidator freezes the rights of unsecured,²⁶⁹ but not secured,²⁷⁰ creditors.

Factors discouraging use of creditors' schemes

3.10 Some directors may nevertheless be disinclined to use schemes of arrangement for corporate rehabilitation, given:

- the need for both initial and final court approval
- the directors' potential personal criminal and civil liability for any insolvent trading²⁷¹ during a scheme's preparation period (which can be considerable, given the need to prepare the necessary documentation and subsequently obtain creditor and court approval), given that the directors retain their functions and powers. This problem does not arise if a company successfully applies to the court for the appointment of a provisional liquidator during this preparation period, as this appointment suspends the functions and powers of directors and other corporate officers.²⁷² Likewise, the issue of personal liability does not arise for directors under VA, as they are replaced from the outset by the administrator (who assumes personal liability for various debts incurred during the administration, subject to a right to an indemnity out of the company's assets),²⁷³ and
- there is no moratorium on the enforcement of personal guarantees against directors during the period prior to approval of a scheme of arrangement²⁷⁴ or under the scheme itself unless provided for in that scheme. By contrast, entering into a VA immediately creates this moratorium.²⁷⁵

3.11 In addition, the need to have separate meetings, and approval, of each class of creditors under a scheme of arrangement (but not a VA) may result in:

- disputes over how to divide the creditors into separate classes. A court may refuse to approve a scheme if it considers that the creditors have not been properly classified
- some classes of creditors using their voting rights to, in effect, greenmail the other participants in the scheme or block the possibility of a successful scheme.

²⁶⁸ The court may appoint a provisional liquidator and control the exercise of that person's powers: s 472(2)–(6). See generally HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (loose leaf, Butterworths) at [27.102].

²⁶⁹ s 471B.

²⁷⁰ s 471C.

²⁷¹ ss 588G ff. See generally HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (loose leaf, Butterworths) at [20.080]–[20.150].

²⁷² s 471A(2).

²⁷³ For the same reason, directors may prefer to employ a VA rather than a creditors' voluntary winding up (CVWU) to liquidate their company. In a VA, they obtain immediate insolvent trading protection. By contrast, under a CVWU, there may be a delay of some weeks before the meeting of creditors is held to pass a resolution appointing a liquidator. During this interim period, the directors run the risk of liability for insolvent trading if the company continues to trade.

²⁷⁴ The court's discretionary power under s 411(16) only applies to claims against the company and therefore does not extend to personal guarantees by directors.

²⁷⁵ s 440J.

Invitation for submissions on Chapter 3

3.12 Submissions are invited on any suggestions that may assist in making the Part 5.1 scheme of arrangement provisions more useful for rehabilitating large and complex enterprises.