Law Council
OF AUSTRALIA

Mr John Kluver
Executive Director
Corporations & Markets Advisory Committee
GPO Box 3967
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Dear Mr Kluver

CORPORATIONS AND MARKETS ADVISORY COMMITTEE DISCUSSION PAPER
"REHABILITATING LARGE AND COMPLEX ENTERPRISES IN FINANCIAL DIFFICULTIES"

I refer to your request for submissions on issues raised in the discussion paper September 2003.

The Law Council thanks the Corporations and Markets Advisory Committee ("CAMAC") for seeking submissions with respect to its discussion paper on Rehabilitating Large and Complex Enterprises in Financial Difficulties ("the discussion paper").

This submission has been prepared by the Insolvency & Reconstruction Committee of the Business Law Section of the Law Council of Australia ("the Committee"). The submissions have been endorsed by the Business Law Section, but not considered by the Council of the Law Council of Australia.

A number of issues that are dealt with the discussion paper have already been addressed by the committee in its submissions to the Enquiry into Australia's Insolvency Laws being carried out by the Parliamentary Joint Committee on Corporations & Financial Services. Those submissions (together with others from other interested bodies) can be viewed on www.aph.gov.au/Senate/committee/corporations_ctte/inquire.

Executive Summary – Parts 5.1 and 5.3A Corporations Act

A summary of the recommendations are as follows:

A. The voluntary administration procedure set out in Part 5.3A of the Corporations Act does provide an effective method for corporate rehabilitation for both small and large complex administrations.

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B. The provisions of 5.3A require no substantial change. The legislative framework is flexible enough to deal with all forms of corporate administration.

C. The period for holding the first meeting of creditors should be extended to at least 10 business days after the voluntary administration period begins and the second meeting timeframe should be extended to 28 days.

D. Section 447A of the Corporations Act should be amended to make it clear the Court does have the power to extend time limits generally.

E. Part 5.1 of the Corporations Act should be retained.

The Committee's submissions are set out in detail below using the same headings and paragraph numbers as the discussion paper.

Principles for effective corporate rehabilitation

1.6-1.8 Pre-requisites for initiating the procedure – financial stress test

The Committee prefers the financial stress test that is now in place. The Committee is also of the view that the pre-requisite definition that a company be insolvent or is likely to become insolvent at some future time (section 436A of the Corporations Act) is sufficient and requires no amendment (see also sub-paragraph 2.28.)

1.17 External insolvency practitioner

The Committee favours the control of the process being handled by a suitably qualified insolvency practitioner.

1.20 The board

The Committee does not agree with a system that proposes that the Board retain control.

Although not raised in the discussion paper the Committee recommends that the initiating process could be broadened to allow a creditor or a director, with leave of the Court, to initiate the process to overcome problems that presently exist with two or more directors not being able to agree to resolve to put a company into voluntary. In cases of urgency or circumstances of a deadlock with management, consideration should also be given to allowing Australian Securities Investment Commission ("ASIC"), with leave of the Court, to appoint an administrator.

Encouraging companies to negotiate with creditors

1.44 Ipso facto clauses

In many administrations the appointment of an administrator triggers the enforcement by some creditors or third parties their rights pursuant to contracts. Such action can effectively obliterate the business of the company overnight and eliminates any opportunity an administrator may have to negotiate a sale of business and/or assets. The Committee is of

the view that there should be some constraints on the enforcement of ipso facto clauses so that creditors cannot take such action during the entire period of voluntary administration without leave of the Court or the permission of the administrator.

2. Voluntary administration

2.25 Policy Options : Prohibit appointment by directors when the company is insolvent

The Committee disagrees with the proposition that directors of an already insolvent company should be prohibited from appointing an administrator.

2.28 Permit appointment where there is a "reasonable prospect of insolvency"

The Committee is of the view that Section 436A of the Corporations Act is adequate and no amendment to the appointment definition is required.

2.31 Application to corporate groups

The Committee agrees that Part 5.3A should have application to corporate groups even though one or more of the companies in a group by itself are not insolvent provided that the group as a whole satisfies the pre-requisite.

2.33 Policy options : who should be entitled to appoint

See sub-paragraph 1.20 of these submissions.

2.35 Eligibility of a liquidator to be an administrator

The Committee believes that the distinction between an official liquidator and registered liquidator is no longer necessary and that there should be one single class of liquidator who is only registered and continues to be registered after satisfying high standards with respect to skills and resources as approved by ASIC.

2.52 Rights that Override a VA – Policy options – reducing rights of second creditors

Save for there being a moratorium against creditors enforcing ipso facto clauses (sub-paragraph 1.44 of these submissions) the Committee does not see that there needs to be any other constraints on creditors whether secured or otherwise.

2.61 Timing issues

The Committee is of the view that the time for calling the first and second meeting should be extended to 10 and 28 days respectively. The Committee also suggests that section 447A of the Corporations Act to be amended to make it clear that the Court does have the power to extend time limits generally.

2.77 Notifying Pre-commencement Creditors

The Committee is of the view that no changes are required to the notification requirements. The commercial and flexible approach taken in the administration of Ansett Airlines supports this view. The Committee recommends that a draft deed be sent or made available for inspection at least 5 days prior to the second meeting.

2.82-2.87 Lending to a Company under Administration

The Committee is of the view that it is not necessary to make any changes with respect to the personal liability of an administrator.

2.101 Voting

The Committee recommends that related parties be prohibited from voting except with leave of the Court.

2.12 Remuneration of administrator

The Committee agrees with the Advisory Committee's recommendations for the approval of administrator's fees. The Committee agrees that the Court should have the power to override any agreement between the Administrator and a committee of creditors or the resolution of creditors particularly if the agreement has been obtained because of a mis-understanding or mis-information.

The Committee takes the view that creditors should be given more time to consider the administrator's fees and the administrator should disclose to creditors their past, projected fees and their expenses at the first meeting and provide details of fees (present and future) with the notice of the second meeting. (See the Committee's submissions to the Inquiry into Australian Insolvency Laws.)

2.121 Administrator's indemnity rights

The Committee recommends that the administrator's indemnity be extended to include loan funds. Presently S443A does not make it clear that "loan funds" are "General Debts".

2.127 Voiding antecedent transactions

The Committee does not support any proposed change which would allow administrators to apply to the Court to avoid antecedent transactions. To do so would result in voluntary administrations becoming quasi liquidations. It generally defeats the purpose of voluntary administrations. The public appreciate that any voluntary administration is subject to the rights ASIC have.

2.136 Prospectus Disclosure

The Committee is of the view that offers of security to creditors made under Part 5.3A should be exempt from disclosure under Part 6D. The information supplied in the explanatory statement and the general safeguards contained within Part 5.3A of the Corporations Act are sufficient.

2.144 Effect of takeover provision

The Court should be given express power in proper circumstances to exempt voluntary administration from the takeover provisions. All interested parties including creditors and shareholders should have the right to be heard on such an application.

2.161 Ambit of the court's powers to give directions

The Committee is of the view that whether or not the Court orders a protective direction should be left to the discretion of the Court.

2.168 Set Off

The Committee is of the view that there should be no change to the current law in this area.

2.176 Pooling of assets

The Committee is of the view that administrators should be permitted to pool the administration of several companies in circumstances where no creditor attending a meeting objects to the proposal or the Court otherwise approves.

2.191 Ipso facto clauses

See sub-paragraph 1.44 of the submissions.

2.207 Assigning or terminating executory contracts

The Committee recommends no reform in this area.

2.212 Deed of Compliance with Priority Payments

The Committee is of the view that to provide flexibility creditors should be able to approve arrangements which go outside the priority provisions of section 556 of the Corporations Act. The protection for creditors or classes of creditors is that such arrangements are always subject to being set aside by the Court for being unfairly prejudicial.

2.231 Minimum Number of Directors

The Committee agrees that the requirement for a minimum number of directors is not necessary when a company is in administration or subject to a Deed but prior to a company coming out of administration the minimum requirement should be complied with.

2.232 Change of company name

The Committee agrees that administrators should be able to change the name of the company without a special resolution of shareholders.

Mr John Kluver
Corporations & Markets Advisory Committee

The Committee would welcome the opportunity to further discuss the submission with you.

Yours sincerely,

Michael Lavarch
Secretary- General

9 December 2003