

LEGAL COMMITTEE
OF THE
COMPANIES AND SECURITIES
ADVISORY COMMITTEE

CORPORATE VOLUNTARY
ADMINISTRATION

REPORT

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Preparation of this Report

This Report has been prepared by the Legal Committee of the Companies and Securities Advisory Committee and approved for publication by the Advisory Committee.

The Advisory Committee was established under Part 9 of the Australian Securities Commission Act 1989. The members of the Advisory Committee and the Legal Committee are appointed by the Federal Treasurer. The role of the Legal Committee is to provide expert analysis, assessment and advice to the Advisory Committee in relation to matters referred to it by the Advisory Committee in connection with:

- (a) a proposal to make or amend a national scheme law;
- (b) the operation or administration of a national scheme law;
- (c) law reform in relation to a national scheme law;
- (d) companies, securities or the futures industry; or
- (e) a proposal for improving the efficiency of the securities markets or futures markets.

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Expression of thanks

The Legal Committee thanks Gary Watts and Damian Egan for their particular contribution to this project.

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Introduction

Background to the Report

Law Reform Commission Report

The voluntary administration provisions in Part 5.3A were introduced into the Corporations Law by the Corporate Law Reform Act 1992. The provisions, which came into effect on 23 June 1993, were based on the Australian Law Reform Commission's Report on its *General Insolvency Inquiry* (ALRC 45), which was given to the Federal Government in 1988. This Report has become popularly known as the Harmer Report, after the Commissioner-in-Charge of the Insolvency Reference, Mr RW Harmer.

The voluntary administration provisions were introduced as an alternative to the then existing forms of voluntary insolvency administration, namely schemes of arrangement, official management (repealed with the introduction of Part 5.3A), creditors' voluntary winding up and court winding up. The Law Reform Commission identified deficiencies in each of these forms of administration.

- The procedure for a scheme of arrangement was cumbersome, slow and costly, and was particularly unsuited to the average private company in financial difficulties.¹
- The result of an official management had to be either payment of the company's debts in full or the winding up of the company.²
- Creditors' voluntary winding up provided no ordered administration between the time of calling the meeting of creditors and the appointment of a liquidator. Also, there was no independent information about the financial affairs and conduct of the business of the company at the meeting of creditors.³
- Creditors' voluntary winding up and court winding up generally resulted in the cessation of the business of the company.⁴

In addition to these specific disadvantages, the methods of voluntary insolvency administration were not integrated. For instance, where an insolvent company promoted a scheme of arrangement that was rejected by creditors, it was necessary to incur additional expense to implement an entirely different procedure to bring about a winding up.⁵

The Law Reform Commission considered that there should be a constructive approach to corporate insolvency, for instance, by focusing on the possibility of

¹ Australian Law Reform Commission, *General Insolvency Inquiry* (Australian Government Publishing Service, Canberra, 1988) (ALRC 45), vol 1, para 46.

² ALRC 45, vol 1, para 47.

³ ALRC 45, vol 1, para 49.

⁴ ALRC 45, vol 1, para 45.

⁵ ALRC 45, vol 1, para 51.

saving a business, though not necessarily the company itself, and preserving employment prospects.⁶ The new procedure was designed to be:

- capable of swift implementation
- as uncomplicated and inexpensive as possible, with minimal court involvement
- flexible, providing alternative forms of dealing with the financial affairs of a company.⁷

Legal Committee review

The corporate voluntary administration procedure has been very successful. It is now the most commonly used form of insolvency administration in Australia.

In 1997, the Legal Committee released a Discussion Paper, *Voluntary Insolvency Administration*. This Paper endorsed the voluntary administration procedure as a valuable form of insolvency administration. However, it identified various anomalies and other deficiencies with the procedure that had become apparent in the procedure's first years of operation. The Discussion Paper set out various proposals to resolve these difficulties and otherwise ensure the better functioning of the procedure.

In this Final Report, the Legal Committee puts forward 60 Recommendations for the future operation of the voluntary administration provisions. These recommendations are set out in Appendix 1 to this Report.

Appendix 2 of this Report contains a list of respondents to the Legal Committee's Discussion Paper.

Summary of the Report

This Report consists of the following Chapters.

Chapter 1. Outline of the voluntary administration procedure

This Chapter briefly describes the current voluntary administration provisions.

Chapter 2. The first and major meetings of creditors

This Chapter reviews the timing of the first and major meetings of creditors. It discusses the information to be provided to creditors for those meetings. It also examines the attendance of directors and the procedure to be followed at those meetings.

⁶ ALRC 45, vol 1, para 52.

⁷ ALRC 45, vol 1, para 54; Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 449.

Its recommendations include:

- retaining the first meeting of creditors
- increasing the time within which to hold the first meeting from 5 to 8 business days
- increasing the time within which to hold the major meeting of creditors from 20 to 25 business days
- reducing the time by which the major meeting can be adjourned without court approval from 8½ to 6 weeks
- requiring the company's directors to attend all creditors' meetings (unless otherwise directed by the creditors)
- providing creditors with an opportunity, before deeds of company arrangement are executed, to inspect deeds that are not fully approved at the major meeting of creditors.

Chapter 3: Voting at creditors' meetings

This Chapter examines the majorities that should be required to pass a resolution at creditors' meetings, proxy voting and the voting rights of related parties, secured creditors, employees and property owners. It also discusses the disclosure of voting arrangements.

Its recommendations include:

- maintaining the dual majority by value and by number voting requirement, and the right of secured creditors to vote for the full amount of their debt
- requiring directors and administrators to disclose any known arrangements for voting a particular way on a proposal
- permitting any person to vote in accordance with a special proxy, whether or not that vote is to the person's financial advantage
- permitting employees to vote as creditors on a deed of company arrangement, even if they have priority under that deed
- giving the court a power to constitute owners of property that is pooled in a single enterprise forming part of the company's business as a separate class of creditors for the purpose of voting on a deed of company arrangement and binding all those creditors to the deed.

Chapter 4: Effect of appointment of administrator on creditors

This Chapter examines the impact of a voluntary administration on the rights of particular types of creditors over property owned or used by the company. It also discusses the rights of administrators to deal with that property.

Its principal recommendation is to give administrators a right to sell property subject to pledges, liens or reservation of title clauses, while removing that right from pledgees and lienees during an administration. The Report also proposes safeguards to protect the interests of these creditors.

Chapter 5: Deeds of company arrangement

This Chapter deals with the creditors that should be covered by a deed of company arrangement, the contents of a deed, public disclosure that the company has entered into a deed, the effect of deeds on guarantees and the circumstances in which a deed may be terminated.

Its recommendations include:

- giving companies an express right to apply to the court to exclude the words “subject to deed of company arrangement” from their public documents
- providing that creditors can only terminate a deed by resolution where there is a material breach of the deed that has not been rectified before the resolution is passed.

Chapter 6: Administrators and deed administrators

This Chapter discusses the information that administrators should give to creditors, the administrator’s duty of investigation, the administrator’s personal liability and right of indemnity, the powers of administrators and deed administrators over the company’s property and shares and the notification obligations of administrators and deed administrators.

Its recommendations include:

- requiring administrators to table a statement of personal interest at the first meeting of creditors
- permitting the administrator to consent to a transfer of shares in the company or an alteration in the status of the company’s members
- requiring administrators to disclose to creditors their past and projected fees and expenses
- making clear that an administrator may adopt any existing employment contract entered into by the company only by his or her written consent. However, an administrator should be personally liable for the wages of the company’s employees who continue to provide services with the administrator’s express or implied authority
- ensuring that deed administrators can only sell existing shares in the company either with the prior approval of the holder of those shares or with the leave of the court
- requiring administrators and deed administrators to lodge with the Commission accounts of receipts and payments.

Chapter 7: Winding up proceedings prior to an administration

This Chapter discusses limitations on the right of a company to appoint an administrator after the commencement of winding up proceedings, the power of a liquidator or provisional liquidator to appoint or apply for the replacement of an administrator and the right of a deed administrator to apply to the court to terminate a

winding up. It also examines the right of creditors to apply to the court to appoint an administrator rather than make a winding up order.

Its recommendations include:

- permitting a creditor to request the court to appoint an administrator to a company, rather than wind it up
- specifically providing that directors and chargeholders cannot appoint an administrator to a company in provisional liquidation
- permitting creditors as well as the court to approve the appointment of the liquidator of a company, or the liquidator's business partner, employee or employer, as the administrator of that company
- permitting a deed administrator to apply to the court for an order terminating a winding up
- giving the liquidator or provisional liquidator of a company the right to apply to the court for replacement of the company's administrator.

Chapter 8: Liquidation following an administration

This Chapter deals with technical anomalies involving the voidable transaction and relation-back provisions that currently arise where a company under administration goes into liquidation. It also discusses the disclosure of information concerning the company's financial affairs, the right of creditors to choose their own nominee as liquidator and whether post-deed creditors should have a priority in a winding up. In addition, it examines whether the separate creditors' voluntary winding up procedure should remain.

Its recommendations include:

- providing that, where an application for winding up is followed by a voluntary administration and subsequently by a winding up order, the relation-back day is the day on which that application was filed (regardless of whether the company is wound up by virtue of that application)
- requiring the officer in control of a company under administration, or under a deed of company arrangement, immediately before the company proceeds into liquidation to lodge with the Commission updated material information on the company's affairs
- giving creditors the right to appoint their own nominee as liquidator when a company under administration goes into winding up
- providing that, where a liquidation follows a deed of company arrangement, post-deed creditors should only have a priority in the liquidation over pre-administration creditors where the deed administrator is personally liable for the debts owed to post-deed creditors or where pre-administration creditors agree at the major meeting to include in the deed a priority for post-deed creditors
- abolishing the separate creditors' voluntary winding up procedure.

Chapter 9: Implications for takeovers and fundraising

This Chapter discusses whether there should be any exemptions from the takeover or fundraising provisions for share acquisitions or offers pursuant to a voluntary administration.

It recommends:

- continuing to apply the takeover provisions to any acquisition of shares pursuant to a voluntary administration
- exempting from the fundraising provisions offers or invitations to existing creditors to exchange debt for equity under a deed of company arrangement.

Chapter 10: Other matters

This Chapter covers various miscellaneous matters relevant to voluntary administrations.

It recommends:

- changing all references to days in Part 5.3A of the Corporations Law to “business days”
- requiring any company that changes its name during the course of, or in the 6 months before, a voluntary administration to disclose its former, as well as its current, name on its public documents for the period of that administration or any subsequent liquidation.

This Report does not cover the application of Part 5.3A of the Corporations Law where a number of companies in a corporate group go into voluntary administration. This matter will be dealt with in a forthcoming Advisory Committee Discussion Paper on corporate groups.

Description of the Commission

Prior to 1 July 1998, the Australian Securities Commission (ASC) has been the regulator of Part 5.3A. From 1 July 1998, that regulator is called the Australian Securities and Investments Commission (ASIC). All references to the “Commission” in this Report refer to the ASC or the ASIC, as the case may be.

Chapter 1. Outline of the voluntary administration procedure

This Chapter briefly describes the current voluntary administration provisions.

Objectives of voluntary administration

1.1 The voluntary administration provisions 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 members than would result from an immediate winding up of the company.⁸

Appointment of administrator

1.2 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.⁹ An administrator can be appointed by the company itself,¹⁰ a liquidator or provisional liquidator¹¹ or a chargee over all or substantially all the property of a company, where the charge is enforceable.¹² An administrator must notify a chargee whose charge relates to all or substantially all the property of a company of the administrator's appointment, unless the chargee is the administrator's appointor.¹³ 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.¹⁴

1.3 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.¹⁵ During that period, its officers (other than the administrator) cannot exercise any function, except with the administrator's written approval.¹⁶

⁸ s 435A.

⁹ ALRC 45, vol 1, para 44.

¹⁰ s 436A.

¹¹ s 436B.

¹² s 436C.

¹³ s 450A(3), (4).

¹⁴ s 441A, s 9 definition of "decision period".

¹⁵ ss 437A, 437B.

¹⁶ s 437C.

Moratorium

1.4 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.

1.5 The moratorium prevents:

- the company from being wound up voluntarily¹⁷
- charges from being enforced¹⁸ (except charges over all or substantially all the property of a company that are enforced within the 10 business day decision period,¹⁹ charges where the enforcement action has begun before the appointment of an administrator,²⁰ and charges over perishable property²¹)
- an owner or lessor from recovering property which is being used by the company²² (except where the owner or lessor has already begun to exercise rights to repossess the relevant property before the administrator was appointed²³ or where the property is perishable²⁴)
- proceedings against the company and any enforcement action in relation to proceedings already taken.²⁵

1.6 Where a chargee (other than a chargee over all or substantially all the property of a company, 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.²⁶ This prevents particular chargees, owners or lessors from destroying the prospects of the business, provided their rights can be protected in some other way.²⁷

¹⁷ 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)).

¹⁸ s 440B.

¹⁹ s 441A, s 9 definition of "decision period".

²⁰ s 441B.

²¹ s 441C.

²² s 440C.

²³ s 441F.

²⁴ s 441G.

²⁵ ss 440D, 440F, s 9 definition of "enforcement process".

²⁶ ss 441D, 441H.

²⁷ Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 533.

1.7 In addition to the moratorium on actions against the company under administration, there is a stay of enforcement during the administration of any guarantees by directors of the company or their relatives.²⁸

Personal liability of administrator

1.8 Administrators are personally liable for debts they incur on behalf of companies under administration,²⁹ but are entitled to an indemnity out of the companies' property for those debts.³⁰

First meeting of creditors

1.9 The administrator must hold a first meeting of creditors within 5 business days of appointment.³¹ At this meeting, creditors decide whether to appoint a committee of creditors.³² They also have the opportunity to replace the administrator with their own appointee.³³

Major meeting of creditors

1.10 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)³⁴ and must be held no later than five business days after the end of the convening period.³⁵

1.11 At that meeting, the creditors may resolve:

- that the company execute a deed of company arrangement, or
- that the administration should end, or
- that the company be wound up.³⁶

1.12 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 business, property, affairs and financial circumstances and, if a deed of company arrangement is proposed, a statement setting out details of the proposed deed.³⁷

²⁸ s 440J.

²⁹ ss 443A, 443B, 443BA.

³⁰ s 443D.

³¹ s 436E.

³² s 436E(1).

³³ s 436E(4).

³⁴ s 439A(1), (5).

³⁵ s 439A(2). Creditors must be given 5 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.

³⁶ s 439C.

³⁷ s 439A(4).

Deed of company arrangement

1.13 If the creditors resolve to accept a deed of company arrangement, the deed must be executed by the company and the deed administrator.³⁸ 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).³⁹ The deed administrator must execute the deed before, or as soon as practicable after, the company executes it.⁴⁰ The administration ends once the company becomes subject to the deed of company arrangement.⁴¹ Deeds are administered by the deed administrator or by the company's directors.

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

- all unsecured creditors of the company⁴²
- secured creditors of the company who have voted for the deed⁴³
- owners or lessors of property possessed, used or occupied by the company who have voted for the deed⁴⁴
- the company⁴⁵
- the company's officers and members,⁴⁶ and
- the deed's administrator.⁴⁷

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

- enforcement of their rights would materially adversely affect the arrangement, and
- their interests are otherwise adequately protected.⁴⁸

³⁸ s 444B(6).

³⁹ s 444B(2).

⁴⁰ s 444B(5).

⁴¹ s 435C(1)(b), (2)(a).

⁴² s 444D(1).

⁴³ 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).

⁴⁴ s 444D(1), (3). The legal rights and restrictions in relation to these creditors are similar to those for secured creditors (see previous footnote).

⁴⁵ s 444G(a).

⁴⁶ s 444G(b).

⁴⁷ s 444G(c).

⁴⁸ ss 444D(2), (3), 444F.

1.16 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.⁴⁹ Creditors may vary or terminate a deed of company arrangement.⁵⁰

Role of the court

1.17 Court approval is not required to conduct a voluntary administration. Instead, the court has general supervisory powers in relation to voluntary administrations, for instance, to determine points of law, to remove an administrator or to terminate a deed of company arrangement.⁵¹

⁴⁹ s 444E.

⁵⁰ ss 445A, 445C(b), 445E, 445F.

⁵¹ ss 445B, 445C(a), 445D, 445G, Division 13. P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 207 contains a list of court powers in relation to voluntary administration.

Chapter 2. The first and major meetings of creditors

This Chapter reviews the timing of the first and major meetings of creditors. It discusses the information to be provided to creditors for those meetings. It also examines the attendance of directors and the procedure to be followed at those meetings.

If and when to hold a first meeting

Current law

2.1 Part 5.3A requires the administrator to call a first meeting of creditors, to be held within 5 business days after the administration begins.⁵² Creditors must receive at least 2 business days' notice of the meeting.⁵³ The first meeting gives the creditors an opportunity to:

- determine whether to appoint a committee of creditors,⁵⁴ and
- remove the administrator from office and appoint someone else as administrator.⁵⁵

Timing problems

2.2 There are two problems with the first meeting.

- Notice of the meeting is very short. For instance, the creditors may not be sufficiently organised or have sufficient information to exercise their right to replace the administrator in the short time between the appointment of the administrator and the holding of the first meeting.⁵⁶
- The timing of the meeting does not usually allow detailed information about the company to be given to creditors.

2.3 The Legal Committee in its Discussion Paper considered two options for overcoming these problems:

- abolish the first meeting, but give creditors a right, at any time before the administrator convenes the major meeting, to require the administrator to convene a meeting to replace the administrator or elect a committee of creditors and also a right to elect a committee of creditors at the major meeting (Option A), or

⁵² s 436E(1), (2).

⁵³ s 436E(3). The general requirement to give 14 days' notice of a meeting does not apply to notice of a first meeting of creditors under Part 5.3A: Corp Reg 5.6.12(1B)(a).

⁵⁴ s 436E(1). "Committee of creditors" is defined in s 9.

⁵⁵ s 436E(4). Creditors might choose to exercise this right, for instance, where they consider that the administrator is too sympathetic to the existing management: Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 475.

⁵⁶ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 26. Also, creditors have little time to make arrangements to participate in the first meeting by telephone under Corp Reg 5.6.13A: see P Crutchfield, *id* at 74-75.

- retain the first meeting, but increase the time for holding it to 8 business days after the beginning of the administration, with 3 business days' notice of the meeting to creditors (Option B).⁵⁷

2.4 The Legal Committee in its Discussion Paper placed considerable importance on the creditors' rights to replace the existing administrator with their own nominee⁵⁸ and to appoint a committee of creditors⁵⁹ (notwithstanding that the Law Reform Commission Report did not recommend either of these rights⁶⁰). If the first meeting were to be abolished, the Committee considered that creditors should nevertheless have the right to require the administrator to convene a meeting of creditors for either, or both, of these purposes at any time before the administrator convenes the major meeting.

Option A: Abolition of first meeting

2.5 The majority of submissions strongly opposed the abolition of the first meeting.⁶¹ The Legal Committee in its Discussion Paper canvassed the advantages and disadvantages of abolishing the first meeting.

2.6 The Discussion Paper noted the following arguments for abolishing the first meeting:⁶²

- it only has a limited purpose
- it has no equivalent in Part X of the Bankruptcy Act
- it was not included in the Law Reform Commission's proposals for corporate voluntary administration

⁵⁷ Issue 1.

⁵⁸ Creditors also have an opportunity to replace an administrator who has been appointed to fill a vacancy (other than one appointed by the court): s 449C(4).

⁵⁹ The appointment of a committee of creditors to liaise with the administrator during the administration was regarded as a means of ensuring that creditors are kept fully informed during the administration: Explanatory Memorandum to the Corporate Law Reform Bill 1992 para 467. Also, "it may be more appropriate to involve creditors who are knowledgeable in the industry and who can provide advice for the specific terms required for inclusion in the deed of company arrangement to induce other creditors to accept it": M Rose & LJ Law, "Voluntary Administrations: Will They Work?" (1995) 3 *Insolvency Law Journal* 11 at 14.

⁶⁰ The Law Reform Commission recommended a power for the court to remove the administrator on application by a creditor of the company: ALRC 45, vol 1, para 85, vol 2, s VA19. This recommendation is adopted in s 449B.

⁶¹ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, Voluntary Administration Law Reform Committee (VALRC) *Submission*, Westpac *Submission*. P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 75-76 and MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91] also support retention of the first meeting. Only two submissions (Allen Allen & Hemsley for QIDC *Submission* and Richard Fisher *Submission*) favoured abolishing the first meeting.

⁶² At 16.

- the time administrators spend in calling the first meeting may detract from their ability to assess the company's affairs and to prepare for the major meeting
- the right to replace the administrator is not often exercised and, in any case, can be given to creditors without requiring a first meeting for every administration
- the proposal that administrators prepare and circulate to creditors a statement giving details of any connections they have with the company or its management⁶³ would give creditors information to determine whether they want to call a meeting to change the administrator
- the time for calling the first meeting does not allow creditors to obtain any meaningful information
- creditors who want information can contact the administrator
- the expense of calling a first meeting can reduce a company's scarce resources.

2.7 The Discussion Paper and submissions on that Paper noted the following arguments for retaining the first meeting:

- the opportunity to substitute the creditors' nominee for the directors' choice as administrator and to appoint a committee of creditors is very important and should not require the creditors to take positive action to call a meeting⁶⁴
- creditors should be given the earliest opportunity to find out what is happening to the company and their prospects for payment⁶⁵
- the meeting gives creditors an opportunity to discuss possible common approaches, including whether to change the administrator or elect a committee of creditors⁶⁶
- a first meeting can deter directors from appointing an administrator who may be seen as not independent⁶⁷
- the first meeting allows creditors to "let off steam" so that the proposal for the future of the company can be considered more dispassionately at the second meeting⁶⁸
- the first meeting assists administrators in gathering information and investigating companies.⁶⁹

⁶³ Proposal 8 of the Discussion Paper, now Recommendation 36 of this Report.

⁶⁴ Discussion Paper at 16, Australian Credit Forum *Submission*, Ernst & Young *Submission*, VALRC *Submission*.

⁶⁵ Discussion Paper at 16, Australian Institute of Credit Management *Submission*. P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 75-76 also notes that the first meeting serves the important purpose of giving the creditors the opportunity to see and hear from the administrator and have the administration process explained to them.

⁶⁶ Discussion Paper at 16-17.

⁶⁷ Discussion Paper at 17.

⁶⁸ Ernst & Young *Submission*. See also C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 9.

⁶⁹ Ernst & Young *Submission*.

2.8 Some of the arguments for retaining the first meeting were directed against the alternative, namely permitting creditors to call a meeting at any time before the administrator convenes the major meeting (Option A in the Discussion Paper).

- The alternative could result in two creditors' meetings within a short time.⁷⁰
- The incumbent administrator would face the uncertainty of whether a meeting would be requisitioned to remove the administrator, particularly as this meeting could be requisitioned up until the time of the second meeting. This uncertainty would distract the administrator and make it difficult for the administrator to enter into commitments for the remaining period of the administration. A compulsory meeting to be held within a fixed time is more certain.⁷¹
- The costs and time in convening and holding the meeting are usually in giving notice, not in the actual holding of the meeting.⁷² Notice of the administrator's appointment would still be required under Option A, as would an additional notice of any meeting that the creditors required the administrator to call.

2.9 Taking into account the views put forward in submissions, the Legal Committee considers that the first meeting should be retained.

Recommendation 1. The first meeting of creditors should be retained.

Option B: Allowing a longer time for the first meeting

Period for holding the first meeting

2.10 Most submissions favoured allowing a longer period for holding the first meeting of creditors (Option B in the Discussion Paper).⁷³ Option B involved an increase in the period to 8 business days after the beginning of the administration, with at least 3 business days' notice of the meeting to creditors.

2.11 This change in timing would still fit in with the general timetable for an administration, as:

- the directors would generally have given the administrator their statement about the company's business, property, affairs and financial circumstances within the proposed 8 business day period⁷⁴

⁷⁰ Discussion Paper at 17.

⁷¹ Ernst & Young *Submission*.

⁷² Ernst & Young *Submission*.

⁷³ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, Westpac *Submission*.

⁷⁴ This statement must be given within 7 days after the administration begins or such longer period as the administrator allows: s 438B(2).

- the administrator would have determined whether the company will continue to use leased property before the end of the proposed 8 business day period⁷⁵
- the holder of a charge over all (or substantially all) the property of a company has 10 business days to decide whether to enforce the charge.⁷⁶ These chargees (usually banks) often await the outcome of the first meeting before making this decision.

2.12 Some of the submissions favouring a longer period suggested 10, rather than 8, business days.⁷⁷ However, the Legal Committee in its Discussion Paper recognised⁷⁸ that any adjustment to the timing of the first meeting should not be substantial, as:

- administrations should proceed expeditiously
- creditors may otherwise feel less inclined ever to exercise their right to change the administrator, who will have performed a substantial amount of work and become conversant with the company's affairs⁷⁹
- administrators may consider their appointment as being in some sense provisional until creditors have met, given creditors' power to appoint a new administrator.

2.13 One submission favoured retaining the current time requirements for the first meeting (though making changes to improve the efficacy of that meeting), as creditors should be informed as soon as possible of the company's affairs, and be given the earliest opportunity to make appropriate enquiries about their position.⁸⁰ However, an early opportunity to make enquiries may not benefit creditors if the administrator has not had sufficient time to conduct even a preliminary investigation of the company's affairs.

Period of notice

2.14 Under Option B in the Discussion Paper, creditors would receive three, rather than two, business days' notice of the first meeting, while the time for holding that meeting would be increased from five to eight business days. Two submissions proposed giving creditors five business days' notice of the first meeting (for instance, to give them more time to consider whether they will change the administrator).⁸¹ This modification to Option B would mean that all of the three extra business days would be used to give creditors additional notice of the first meeting (that is, an increase from two to five business days), rather than to give administrators extra time to send out the notices of meeting (administrators would continue to have three business days from their appointment to do this).

⁷⁵ s 443B.

⁷⁶ s 441A, s 9 definition of "decision period".

⁷⁷ Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*.

⁷⁸ At 18.

⁷⁹ A Keay, "Part 5.3A of the Corporations Law: An Update on Meetings", Ferrier Hodgson Insolvency Seminar, 21 September 1995 at 3, A Keay, "Voluntary Administrations: The Convening and Conducting of Meetings" (1996) 4 *Insolvency Law Journal* 9 at 10.

⁸⁰ VALRC *Submission*.

⁸¹ Geoff McDonald *Submission*, Westpac *Submission*.

2.15 The Legal Committee agrees with this modification, as one of the key problems with the first meeting was that notice of the meeting is very short.

2.16 The other problem was that the timing of the first meeting does not usually allow detailed information about the company to be given to creditors at that meeting. This problem would be alleviated by the additional time for holding the first meeting.

Recommendation 2. The time for holding the first meeting should be increased to 8 business days after the beginning of the administration, with 5 business days' notice of the meeting to creditors.

List of creditors

2.17 The Legal Committee in its Discussion Paper raised the possibility of giving each creditor a list of all the company's creditors, to facilitate communication between them.

2.18 Some submissions favoured requiring administrators to send all creditors a list of creditors.⁸² One of these respondents suggested that this would permit creditors to discuss with each other the directors' nominee as administrator.⁸³

2.19 By contrast, another submission said that a requirement to circulate a list of creditors would probably be excessively onerous for company administrations with large numbers of creditors.⁸⁴ The Legal Committee agrees. The administrator should not have a statutory obligation to send all creditors a list of creditors. Individual creditors could obtain that list from the administrator.

Agenda for the first meeting

2.20 One respondent⁸⁵ proposed that there be a standardised agenda of issues to be covered at the first meeting. It could take the following form:

1. Tabling of administrator's consent to act (to contain details of the administrator's prior involvement with the company)
2. Background of the company's affairs and circumstances leading up to the administrator's appointment
3. Consideration of the company's financial position:

⁸² Australian Credit Forum *Submission* (which also suggested that the list should disclose the known outstanding indebtedness of the company to each creditor), Major Airconditioning & Refrigeration Suppliers *Submission*. See also MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91]. The Ernst & Young *Submission* only favoured requiring administrators to send all creditors a list of creditors if the first meeting were abolished. That submission did not favour abolition of the first meeting.

⁸³ Australian Credit Forum *Submission*.

⁸⁴ Richard Fisher *Submission*.

⁸⁵ VALRC *Submission*.

- (a) tabling of summarised report as to affairs from directors
 - (b) tabling of directors' statement (if one prepared)
- 4. Consideration whether a proposal may be formulated, and if so its structure and type
- 5. Consideration of basis of charging remuneration by the administrator
- 6. Discussion/questions from the floor
- 7. Formal business:
 - (a) appointment of a committee of creditors
 - (b) replacement of administrator (if proposed)
- 8. Closure.

2.21 The Legal Committee considers that this would be a very useful model agenda for particular administrations. However, the Committee does not support any statutory prescription of the agenda for first meetings. This should remain as a matter of industry best practice.

Additional purposes of the first meeting

2.22 One commentator has proposed⁸⁶ that, in addition to the two purposes for the first meeting set out in the Corporations Law,⁸⁷ the Law should require the administrator to give information for other purposes at the first meeting, namely:

- (a) an explanation of the relevant circumstances leading up to the administrator's appointment, including any involvement the administrator had in that process
- (b) an oral overview of certain prescribed key features of the voluntary administration procedure (in particular, the administrator's own role)
- (c) the investigations to be undertaken (for instance, into voidable transactions and actions against directors and other persons associated with the company) to enable the administrator to advise creditors of the anticipated return if the company were liquidated
- (d) any initial observations about the company's asset and trading position and the anticipated work in preparing a detailed report about the company's financial position for the major meeting

⁸⁶ C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 7-8.

⁸⁷ s 436E(1), (4).

- (e) the administrator's preliminary observations about the company's possible options and, if appropriate, the administrator's likely preferred option
- (f) whether the administrator intends to trade all or part of the company's business during the administration period and what factors might change that position at short notice
- (g) whether there are any circumstances that might require an urgent sale of the business or undertaking of the company as a going concern before the major meeting (albeit on the basis that the sale was conditional on creditor approval at the major meeting).

2.23 The commentator suggested that prescribing these additional purposes for the first meeting would:

- give creditors at the major meeting greater confidence in the administrator's recommendations about the future direction of the company
- reduce the likelihood of creditors' deliberations at the major meeting being diverted by emotive creditors and by matters which the administrator has not investigated.

2.24 The Legal Committee considers that this additional information could be very valuable in particular cases. However, it does not favour the legislation stipulating any additional purposes for the first meeting. Administrators should determine for themselves whether to provide this information to creditors in a particular administration.

Committee of creditors

Composition of committee

2.25 The first meeting of the company's creditors determines:

- whether to appoint a committee of creditors, and
- if so, who are to be the committee's members.⁸⁸

2.26 One commentator has proposed that, in addition to the creditors electing committee members at the first meeting, the administrator should have a power to appoint other creditors to the committee (with the consent of those additional creditors), for the following reasons.⁸⁹

- The administrator could ensure that the committee represents as many of the different categories of the company's creditors as possible.
- Administrators have particular regard to the views of the committee of creditors in developing deeds of company arrangement. If the views of key

⁸⁸ s 436E(1).

⁸⁹ C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 12.

creditors (for instance, those whose debt constitutes a significant proportion of the debt owed by the company) are not taken into account because they have not been elected to the committee by the creditors, the deed may not obtain the approval of the requisite majority of creditors or, if it does, it may not operate effectively and may be terminated.

2.27 The Legal Committee does not consider that the administrator should have a power to co-opt creditors to the committee. Only the creditors should have the power to elect committee members. It is in their interests to elect a committee that is sufficiently representative to maximise the chances of the administration's success.

Ratification by committee

2.28 The functions of the committee of creditors are:

- to consult with the administrator about matters relating to the administration, and
- to receive and consider reports by the administrator.⁹⁰

2.29 The Corporations Law requires administrators to report to the committee of creditors about matters relating to the administration as and when the committee reasonably requires.⁹¹ However, the committee cannot otherwise give directions to the administrator.⁹² An administrator therefore cannot obtain the creditors' ratification of a particular course of action. By contrast, a liquidator in a court winding up must have regard to any directions given by resolution of the creditors or by the committee of inspection.⁹³ The liquidator may convene general meetings of creditors to ascertain their wishes.⁹⁴

2.30 Administrators may have to make decisions in the interests of creditors, on the basis of whatever information is available to them. The Legal Committee in its Discussion Paper considered a proposal that would give the committee a ratification power and also protect administrators from liability where:

- they have explained the reasons for a course of action to the committee of creditors and request the committee to ratify that course
- the committee's decision is made in a bona fide manner
- the committee is not misled by the administrator when giving its approval
- the committee's decision is in the best interests of creditors as a whole.

2.31 The Legal Committee did not favour this ratification and immunity proposal, as:

- the administrator can obtain directions from the court⁹⁵

⁹⁰ s 436F(1).

⁹¹ s 436F(3).

⁹² s 436F(2).

⁹³ s 479(1).

⁹⁴ s 479(2).

⁹⁵ s 447D.

- the proposal could place too much responsibility on the committee of creditors to identify the best interests of all creditors
- the responsibility for conducting the administration should remain with the administrator.

2.32 No submissions favoured the proposal. One respondent, in agreeing with the Legal Committee's view, pointed out that if ratification were permitted, there could be significant arguments about whether or not a committee had been misled by the administrator and what information should have been provided to the committee to enable an informed answer or direction to be given.⁹⁶

Replacement of the administrator

Proposal to replace the administrator

2.33 Currently, the first meeting of creditors can, without prior notice, vote to replace the administrator.⁹⁷

2.34 One submission said that, in this situation, the first meeting should be adjourned so that all creditors have the option of considering this proposal. The submission said that those who do not attend the meeting or do not send proxies would not know of any approach to replace the administrator, and should have the opportunity of considering the matter.⁹⁸

2.35 The Legal Committee does not agree. It is important that the first meeting be concluded within the time stipulated in the legislation, as the voluntary administration procedure should be carried out as expeditiously as possible. Also, the holder of a charge over all (or substantially all) the property of a company has 10 business days to decide whether to enforce the charge.⁹⁹ These chargees (usually banks) often await the outcome of the first meeting before making this decision. Given that the possible appointment of a replacement administrator is one of the key matters for consideration at the first meeting, creditors should take responsibility for being represented in person or by proxy.

Notices by prospective replacement administrators

2.36 Currently, any prospective administrator must consent to the appointment in writing.¹⁰⁰ The Legal Committee proposed in its Discussion Paper that a copy of this written consent, together with a statement of interest of the proposed replacement administrator and an indication of which creditor intends to propose that person, be sent to all creditors before the meeting.¹⁰¹

⁹⁶ Geoff McDonald *Submission*.

⁹⁷ s 436E(4).

⁹⁸ Robert MH Cole & Co *Submission*.

⁹⁹ s 441A, s 9 definition of "decision period".

¹⁰⁰ s 448A.

¹⁰¹ At 28. Recommendation 36, post, sets out the content of the statement of interest.

2.37 Some submissions supported this proposal.¹⁰² However, other respondents regarded any notice requirement as impractical.¹⁰³ For instance:

- many prospective administrators are only approached by creditors very shortly before the first meeting¹⁰⁴
- there is no mechanism for a replacement administrator to obtain a list of creditors¹⁰⁵
- even if it were feasible to send the statements, it would be unduly costly.¹⁰⁶

2.38 The submissions that disagreed with this element of the proposal suggested that the statements could be tabled at the first meeting of creditors. The Legal Committee agrees.

Single resolution

2.39 Currently, the replacement of an administrator at the first meeting¹⁰⁷ may require creditors to pass two separate resolutions:

- the first to remove the existing administrator
- the second to appoint the replacement administrator.

2.40 Consequently, an administrator could be removed from office without another being appointed.¹⁰⁸ Any vacancy in the office of administrator may have to be filled by the directors appointing another administrator.¹⁰⁹

2.41 In its Discussion Paper, the Legal Committee proposed that the uncertainty over whether two resolutions are required should be removed by a specific requirement that the removal of a current administrator and the appointment of a new administrator must be effected through a single resolution.¹¹⁰

¹⁰² Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, Robert MH Cole & Co *Submission*.

¹⁰³ The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

¹⁰⁴ Law Council of Australia *Submission*, VALRC *Submission*.

¹⁰⁵ Geoff McDonald *Submission*.

¹⁰⁶ Geoff McDonald *Submission*.

¹⁰⁷ s 436E(4).

¹⁰⁸ Also, s 436E(4) could be interpreted as enabling creditors to appoint an additional administrator without removing the incumbent, though the Explanatory Memorandum to the Corporate Law Reform Bill 1992 para 475 appears to assume that creditors may only appoint a new administrator when replacing the original administrator: P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 76. Contrast s 449C(4) under which a new administrator appointed to fill a vacancy arising through death, resignation or becoming ineligible to act must call a meeting of creditors “so that they may:

(a) determine whether to remove the person from office; and
(b) *if so*, appoint someone else as administrator of the company”.

¹⁰⁹ s 449C.

¹¹⁰ Proposal 9.

2.42 Submissions that commented on this proposal unanimously supported a specific requirement that removal and replacement of an administrator should be effected through a single resolution.¹¹¹

Prerequisites for exercise of removal power

2.43 There are no prerequisites for the exercise of the creditors' power to replace an administrator, and creditors need not give any reasons in passing the resolution. One commentator has suggested that, to minimise frivolous or unfounded challenges, a creditor should be required to cite all of the creditor's reasons for challenging the appointment of the administrator before proposing a resolution that the administrator be removed.¹¹²

2.44 The Legal Committee considers that this suggestion would unduly fetter creditors' legitimate discretion. Also, the mere citing of reasons would not prevent frivolous or unfounded challenges. The commentator did not indicate whether any "proper purpose" test should apply to any given reasons or whether specified grounds for removal should be included in the legislation.

Recommendation 3. There should be a specific provision stating that creditors may only remove an administrator and appoint a replacement administrator through a single resolution.

The prospective replacement administrator should table at the first meeting, prior to any resolution:

- a written consent to act, and
- a statement of interest.

¹¹¹ The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*. The Ernst & Young *Submission* pointed out that, where more than one nomination is received, a series of these resolutions would be required.

¹¹² C Hinchin, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 9.

Material to be provided to creditors

Directors' statement relating the administration to the objectives of Part 5.3A

2.45 In its Discussion Paper, the Legal Committee proposed that when directors (but not liquidators, provisional liquidators or chargeholders) appoint an administrator, they should be required to disclose to creditors at the first meeting how they seek to meet the objectives of Part 5.3A¹¹³ through that appointment.¹¹⁴ This requirement might:

- increase the appreciation of the objectives of Part 5.3A by directors, the administrator, creditors and others, and
- decrease the number of occasions when an administrator is appointed without any regard to the objectives of Part 5.3A.

2.46 Some submissions supported this proposal.¹¹⁵ One submission said that it would discourage directors from appointing an administrator merely to frustrate creditors who have applied to have a company wound up.¹¹⁶ However, these creditors can seek to have a provisional liquidator appointed. The Committee elsewhere recommends that the directors should not be entitled to appoint an administrator once a provisional liquidator has been appointed.¹¹⁷

2.47 Most submissions opposed the proposal,¹¹⁸ for the following reasons.

- The proposal detracts from the objectives of the voluntary administration procedure, namely, the appointment of an independent person to manage the company's affairs and to form an objective view as to which of the prescribed options might best advance the interests of its creditors. Directors may properly appoint an administrator simply because they themselves have no idea of the appropriate course for dealing with the company's affairs.¹¹⁹
- The requirement would serve no useful purpose, as many directors are motivated, to a greater or lesser extent, by the need to limit their personal

¹¹³ See para 1.1, *supra*.

¹¹⁴ Proposal 11. The ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 7.103 discusses the various reasons why companies enter into voluntary administration.

¹¹⁵ Australian Credit Forum *Submission*, Horwath *Submission*, David Kerr *Submission*, Westpac *Submission*. MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91] also supported the proposal.

¹¹⁶ David Kerr *Submission*.

¹¹⁷ Recommendation 45, *post*.

¹¹⁸ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Richard Fisher *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*. See also P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 62-63.

¹¹⁹ Richard Fisher *Submission*.

liability for insolvent trading or penalty notices issued by the Australian Taxation Office.¹²⁰

- There may be no practical benefit in introducing such a requirement. The directors' statement would in practice be prepared by their professional advisers, not the directors themselves.¹²¹
- A statement at the first meeting may have little relevance to a proposal that could be affected by circumstances and actions of creditors during the convening period.¹²²
- Often little time is available to consider preparation of such a statement as enquiries of the directors as to the financial position of the company take priority.¹²³
- The administrator should determine how the objectives of Part 5.3A are to be achieved. Neither the directors nor the administrator usually know this at the time of the first meeting.¹²⁴

2.48 The Legal Committee accepts these arguments and no longer supports requiring directors to give a statement of objectives.

Directors' statement of the company's affairs

2.49 Within seven days after the administration of a company begins or such longer period as the administrator allows, the directors must give the administrator a statement about the company's business, property, affairs and financial circumstances.¹²⁵ The Legal Committee in its Discussion Paper proposed that this statement should be tabled at the first meeting of creditors.¹²⁶

2.50 Many submissions supported this proposal.¹²⁷ One of these submissions gave the following reasons.

¹²⁰ Ernst & Young *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*. See also P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 62-63. Voluntary administrations as a means of avoiding actions for insolvent trading are discussed in A Herzberg, "Why Are There So Few Insolvent Trading Cases?" (1998) 6 *Insolvency Law Journal* 77.

¹²¹ Australian Institute of Credit Management *Submission*.

¹²² The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

¹²³ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

¹²⁴ Law Council of Australia *Submission*.

¹²⁵ s 438B(2).

¹²⁶ Proposal 12.

¹²⁷ Allen Allen & Hemsley for QIDC *Submission*, Australian Credit Forum *Submission*, Ernst & Young *Submission*, Horwath *Submission*, Geoff McDonald *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Westpac *Submission*. Also, P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 76 considers that the first meeting could "be made more relevant by requiring the director's statement about the company's business, property, affairs and financial circumstances under s 438B(2) to be provided to the administrator before the first meeting, so that the administrator is in a better position to make some informed comments about the company and its prospects" (see also at 93). MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91] also supports creditors being provided with a report as to affairs.

- It would give creditors the opportunity to identify any errors in the directors' statement and pass that information on to the administrator.
- If the directors know that their statement will be examined by creditors, it should encourage them to make truthful and comprehensive disclosure.¹²⁸

2.51 One submission suggested that the directors' statement should also contain details of related party transactions.¹²⁹ The Legal Committee does not agree. Related party transactions may be with parties other than the directors, who may not necessarily be able to obtain all this information in the limited time for preparing their report. The administrator's report should deal with these matters.¹³⁰

2.52 Some submissions suggested that a prescribed short form summary of affairs might be provided at the first meeting.¹³¹ The Legal Committee understands that the Federal Government and the Commission are reviewing the prescribed forms for voluntary administrations.¹³²

2.53 Other submissions opposed the Discussion Paper proposal,¹³³ for the following reasons:

- the requirement is impracticable and unnecessary¹³⁴
 - additional documentation only adds to cost and reduces efficiency¹³⁵
- Legal Committee response.* The directors' statement must be prepared in any case, so there should be no additional cost.

2.54 One submission disagreed with tabling the statement at the first meeting on the grounds that there may be insufficient time.¹³⁶ That submission favoured making the statement available at the major meeting. Another submission, although supporting the proposal, proposed that there should be a mechanism for deferring the provision of a final statement with the consent of the creditors where the directors can demonstrate that there is insufficient time for them to present an accurate and detailed statement.¹³⁷

2.55 The Legal Committee agrees that in some circumstances, there may be insufficient time for directors to prepare their statement before the first meeting. However, the Committee considers it desirable that the statement be available at the first meeting where possible. The Committee therefore recommends that the administrator should table a comprehensive directors' statement at the first meeting of creditors if the statement is available at that time. If the administrator has allowed the

¹²⁸ Allen Allen & Hemsley for QIDC *Submission*.

¹²⁹ Major Airconditioning & Refrigeration Suppliers *Submission*.

¹³⁰ Directors are required to give the administrator such assistance as the administrator reasonably requires, in addition to their statement about the company's affairs (s 438B(3)).

¹³¹ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, VALRC *Submission*.

¹³² The Legal Committee notes, for instance, the comments in para 7.313 of the ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* that Form 507 does not satisfy the requirement for a directors' statement pursuant to s 438B(2).

¹³³ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

¹³⁴ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

¹³⁵ Australian Institute of Credit Management *Submission*.

¹³⁶ Robert MH Cole & Co *Submission*.

¹³⁷ Westpac *Submission*.

directors additional time to prepare the statement so that the statement is not available until after the first meeting, the administrator should be required to table the statement at the major meeting. Creditors should have no power to defer the time at which the directors must provide the statement.

Recommendation 4. The directors' statement about the company's business, property, affairs and financial circumstances should be tabled:

- at the first meeting of creditors, or
- if the administrator allows directors a longer period to provide this statement - at the major meeting of creditors.

Administrator's report to creditors

2.56 An administrator, when convening the major meeting of creditors, must send them various statements¹³⁸ and a report about the company's business, property, affairs and financial circumstances.¹³⁹ The legislation does not prescribe the content of that report.

2.57 The Legal Committee in its Discussion Paper considered a suggestion that the legislation should give administrators greater guidance on the appropriate contents of the report by prescribing the following matters to be included:

- the history of the company (this could include formal information like the date of incorporation and details of the directors and their other directorships or shareholdings)
- the recent, current and proposed trading or business activities of the company, if any
- the reasons for the company's financial difficulties
- the assets and liabilities of the company (based on the report as to affairs)
- the anticipated return to creditors from liquidation of the company, including all rights of recovery that would arise upon a liquidation (for instance, rights against directors of the company for breaches of their duty to prevent insolvent trading)¹⁴⁰

¹³⁸ Paragraph 439A(4)(b) requires a statement setting out the administrator's opinion, with reasons, about whether it would be in the creditors' interests for:

- the company to execute a deed of company arrangement
- the administration to end, or
- the company to be wound up.

Paragraph 439A(4)(c) requires a statement setting out details of any proposed deed of company arrangement.

¹³⁹ s 439A(4)(a). There is no prescribed form for the report. In *McDonald v Australian Securities Commission* (1996) 22 ACSR 379, (1997) 15 ACLC 1, McLelland CJ in Eq held that Corp Regs 1.03 and Schedule 1 Item 48 were invalid to the extent that they require an administrator's s 439A(4)(a) report accompanying the notice of the major meeting of creditors to follow Form 507 in Corp Regs Schedule 2 (report as to affairs). The Legal Committee understands that the Federal Government and the Commission are reviewing the prescribed forms for voluntary administrations.

¹⁴⁰ Currently, the requirement for the administrator to specify rights of recovery is limited to voidable transactions: Corp Reg 5.3A.02. This requirement does not cover other important rights of recovery, for instance against the company's directors for insolvent trading.

- the details of any proposed deed of company arrangement
- the anticipated return to creditors from a deed of company arrangement
- the administrator's opinion on which alternative is in the best interests of the creditors.

2.58 One commentator¹⁴¹ also favoured prescribing a non-exhaustive list of matters to be dealt with in an administrator's report, as:

- prescription would improve the quality of the reports to creditors
- a general requirement to disclose to creditors all matters which are material to their deliberations at the major meeting gives insufficient direction to administrators, whose professional capabilities vary widely
- there is no disadvantage in providing administrators with non-exhaustive legislative guidance about matters to be included in their reports, particularly if there were an overriding requirement to disclose all material matters
- guidelines on what should be included in reports should not be left to interested professional bodies, which will have differing views.

2.59 A recent ASC Research Paper on voluntary administration favoured the prescription of a detailed checklist of matters to be covered in the administrator's report,¹⁴² together with a requirement that the administrator include any "information that can reasonably be expected to be material to creditors in deciding the company's future direction".¹⁴³ These requirements would assist administrators in providing comprehensive information to creditors.

2.60 The Legal Committee in its Discussion Paper, while recognising the benefits of including detailed information in an administrator's report to creditors, did not support a mandatory legislative checklist of matters to be covered in that report.¹⁴⁴ It considered that specific guidelines would be contrary to the move to general disclosure requirements in the Corporations Law.¹⁴⁵ Instead, the Legal Committee proposed that administrators should be required to include in the report "any other matter material to the creditors' decision".¹⁴⁶

2.61 Some submissions supported the legislation prescribing matters to be incorporated in an administrator's report.¹⁴⁷ Some submissions supported the Discussion Paper proposal that there be a general requirement to disclose material

¹⁴¹ C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 17-19.

¹⁴² ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 1.301.

¹⁴³ *id* at para 1.206(a).

¹⁴⁴ At 32-33.

¹⁴⁵ For instance, s 1022.

¹⁴⁶ Proposal 13.

¹⁴⁷ Horwath *Submission*, VALRC *Submission*, Westpac *Submission*. David Kerr *Submission*, while opposing a black letter law approach, suggested that some minimum content could be prescribed.

matters.¹⁴⁸ Another view was that even this general requirement was unnecessary, may increase uncertainty and could add to the cost and reduce the effectiveness of voluntary administrations.¹⁴⁹

2.62 The Legal Committee, while supporting the principle that administrator's reports should be fully informative, does not consider that this goal would necessarily be achieved by prescribing the minimum content for these reports. That approach could reduce the flexibility of administrators in preparing reports that are appropriate to particular companies. Instead, the Committee sees merit in a general requirement that administrators include in their reports "any other matter material to the creditors' decision". This would require that administrators reports be comprehensive. Also, the omission of material matters may be a ground for terminating the deed.¹⁵⁰

2.63 While ultimate responsibility for reports should rest with administrators, specific matters to which administrators might refer in their reports, for the purpose of satisfying the proposed general requirement, could be developed as a matter of industry best practice.¹⁵¹ These best practice guidelines could be adapted and amended by ongoing industry review. The Legal Committee notes that the Federal Government has maintained a general disclosure requirement in the *Draft Legislative Provisions* released under its Corporate Law Economic Reform Program.¹⁵²

Recommendation 5. The reports sent by administrators when convening the major meeting of creditors should be required to include "any other matter material to the creditors' decision".

Lodgement of report as to affairs with the Commission

2.64 One respondent proposed that the report as to affairs required in the voluntary administration process be lodged with the Commission.¹⁵³ The Legal Committee notes that the report is circulated to all creditors before the major meeting. Also, the general public is put on notice that the company is under administration. To make the report publicly available through lodgement with the Commission could prejudice confidential negotiations for sale of assets or might otherwise require the disclosure of price-sensitive information. The Legal Committee elsewhere recommends that the report (together with updated information) should be lodged with the Commission if and when a company goes into liquidation, given that the issue of confidentiality no longer applies.¹⁵⁴

¹⁴⁸ Australian Credit Forum *Submission*, Ernst & Young *Submission*, Horwath *Submission*, Westpac *Submission*.

¹⁴⁹ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*, Robert MH Cole & Co *Submission*. Also, Geoff McDonald *Submission* neither supported nor objected to the proposal, on the basis that it merely reflected the common law.

¹⁵⁰ s 445D(1)(c), referred to in *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139 at 148, 13 ACLC 885 at 891-892.

¹⁵¹ Compare, for instance, the Standard of Professional Practice issued by the Canadian Insolvency Practitioners Association Concerning the Trustee's Report on the Cashflow Statement.

¹⁵² s 11, pp 20-22 of the draft Bill.

¹⁵³ VALRC *Submission*.

¹⁵⁴ Recommendation 53, post.

Time for holding the major meeting

2.65 After the administrator has had an opportunity to assess the company's affairs, the administrator must call a further meeting of creditors. The purpose of this major meeting is for the creditors to decide the company's fate, on the basis of information supplied by the administrator about the company's circumstances.¹⁵⁵

2.66 Once an administration has commenced, the administrator has 21 days (or 28 days if the administration begins just before Christmas or Easter) (the convening period)¹⁵⁶ to convene the major meeting of creditors by giving creditors:

- notice of the meeting at least 5 business days before the meeting¹⁵⁷
- certain information, including details of any proposed deed of company arrangement.¹⁵⁸

2.67 This major meeting must be held within 5 business days after the end of the convening period.¹⁵⁹ The latest time for holding the major meeting (unless the court extends the convening period¹⁶⁰) is therefore 4 weeks or, if the administration begins just before Christmas or Easter, 5 weeks from the beginning of the administration.

2.68 Under the current law, the time limits for holding the major meeting are often inadequate for administrators to conduct a proper investigation of large companies whose affairs are complex or of small companies whose records are in disarray. Administrators may be unable to provide creditors with sufficient information to make an informed decision. Administrators frequently need to apply to the court for an extension of the time for convening the major meeting.

2.69 A possible argument against extending the time for holding the major meeting is that secured creditors may be reluctant to refrain from taking action if the administration, and hence the moratorium, were extended.

2.70 The Legal Committee in its Discussion Paper proposed, taking all these factors into account, that one extra week should be allowed for holding the major meeting.¹⁶¹ Therefore, taking into account the Legal Committee's recommendation that time periods be expressed in business days,¹⁶² the period for holding the major meeting should be extended from 20 to 25 business days, with the convening period increasing from 15 to 20 business days.

¹⁵⁵ ss 439A(4), 439C.

¹⁵⁶ s 439A(1), (5).

¹⁵⁷ s 439A(3). Written notice must be sent to as many creditors as practicable, and notice of the meeting must be published in a national newspaper or in newspapers in each jurisdiction in which the company carries on business. The general requirement to give 14 days' notice of a meeting does not apply to notice of the major meeting of creditors under Part 5.3A: Corp Reg 5.6.12(1B)(a).

¹⁵⁸ s 439A(4).

¹⁵⁹ s 439A(2).

¹⁶⁰ s 439A(6).

¹⁶¹ Proposal 6.

¹⁶² Recommendation 59, post.

2.71 Submissions supported this proposal.¹⁶³ One submission made the following points in support of this extension of time.¹⁶⁴

- The additional time would assist administrators in preparing their reports to creditors for the major meeting.
- The current very tight timeframes for administrators to complete their investigations into companies' affairs can result in a less than thorough investigation of the options available and a sub-standard report to creditors.

2.72 One commentator has proposed that the first meeting of creditors or the administrator, with the consent of the committee of creditors, should have the right to extend the maximum convening period for up to an additional two weeks.¹⁶⁵ The Legal Committee does not agree. The statutory time periods are intended to ensure the expeditious conduct of a voluntary administration. They should not be extended except with court approval.

2.73 Another issue arose as a result of the decision in *Supervac Australia Pty Ltd v Australasian Memory Pty Ltd*.¹⁶⁶ In that case, Whitlam J held that an administrator could not convene the major meeting of creditors for a date that was earlier than the end of the convening period, as s 439A(2) provides that the meeting "must be held within 5 business days after the end of the convening period". In addition, His Honour regarded an earlier major meeting as inconsistent with the administrator's statutory duties to prepare:

- a report about the company's business, property, affairs and financial circumstances
- an opinion about the company's future, and
- a statement setting out details of any proposed deed of company arrangement.¹⁶⁷

2.74 In fulfilling these duties, an administrator would, for instance, generally take into account the directors' report as to affairs (directors have 7 days to give this report, unless the administrator grants an extension),¹⁶⁸ and whether a chargee over all or substantially all the property of a company has decided whether to enforce its charge within the 10 business day decision period.¹⁶⁹

¹⁶³ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*. See also MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91].

¹⁶⁴ VALRC *Submission*.

¹⁶⁵ MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91]. See also C Anderson and D Morrison, "Voluntary Administrations and Their Effect on the Use of Schemes of Arrangement" (1994) 2 *Insolvency Law Journal* 195 at 201.

¹⁶⁶ Federal Court, 6 June 1997.

¹⁶⁷ s 439A(4).

¹⁶⁸ s 438B(2).

¹⁶⁹ s 441A, s 9 definition of "decision period".

2.75 On the other hand, administrations should be as expeditious as possible.¹⁷⁰ Under the decision in *Supervac*, there would always be at least a 10 business day period after the directors have given their report as to affairs (unless the administrator grants the directors an extension), and a 4 or 5 business day period after the end of the chargee's decision period, before the major meeting could be held. This forced delay may detract from the best use of a company's resources, for instance where the company's taxation affairs need to be resolved within a particular financial year for tax benefits to be realised or where a third party may need to have a deal concluded by a certain date.¹⁷¹

2.76 Some submissions¹⁷² have argued that the result in *Supervac* was unexpected and should be reviewed. The Legal Committee agrees. The administrator should be permitted to hold the major meeting before the end of the convening period.

Recommendation 6. The period for holding the major meeting should be extended to 25 business days, with a new convening period of 20 business days.

The administrator should be permitted to hold the major meeting before the end of the convening period.

Calculating the convening period

2.77 There is a technical peculiarity in calculating the convening period. Currently, that period is calculated from the day when the administration begins.¹⁷³ It would be more usual to calculate from the day after the administration begins. The current unusual method of calculation may jeopardise some administrations. For instance, an administration ends if the administrator fails to convene a meeting or apply to the court for an extension within the convening period,¹⁷⁴ even if the failure results from a mere oversight by the administrator in calculating the length of the convening period.

2.78 The Legal Committee in its Discussion Paper proposed that the convening period time should be calculated from the day after the administration begins.¹⁷⁵ Submissions agreed.¹⁷⁶ The Legal Committee also considers that the notion of a convening period should be retained.¹⁷⁷

¹⁷⁰ ALRC 45, vol 1, para 54.

¹⁷¹ A Harkness, "Inconvenient convening periods: *Supervac Australia Pty Ltd v Australasian Memory Pty Ltd*" (1998) 6 *Insolvency Law Journal* 9 at 11.

¹⁷² David Kerr *Submission*, Law Council of Australia *Submission*, Richard Brien & Co *Submission*.

¹⁷³ s 439A(5). *Cawthorn v Keira Constructions Pty Ltd* (1994) 13 ACSR 337, 12 ACLC 396, *Watson v Uniframes Ltd* (1995) 13 ACLC 609.

¹⁷⁴ s 435C(3)(b).

¹⁷⁵ Proposal 6.

¹⁷⁶ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

¹⁷⁷ The Legal Committee notes the contrary view of MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91].

Recommendation 7. The convening period time should be calculated from the day after the administration begins.

Court power to extend the convening period

2.79 The court has an express power to extend the convening period on application made within that period.¹⁷⁸ There is some difference in the case law about whether the convening period can be extended on application made outside the convening period under the court's general powers, though a number of these applications have been granted.¹⁷⁹

2.80 The Legal Committee in its Discussion Paper proposed¹⁸⁰ that:

- the court's power to extend the convening period should also apply where the administrator applies after that time, but only where there would otherwise be substantial injustice to creditors (for instance, because of technical defects discovered after a meeting has been held)
- the court should have regard to the administrator's conduct (for instance, in failing to properly carry out his or her duties) when considering the costs of that application.

2.81 Submissions agreed.¹⁸¹

¹⁷⁸ s 439A(6).

¹⁷⁹ ss 447A, 1322(4)(d). *Re Madden* (1996) 20 ACSR 10, 14 ACLC 913, *Re Greg Sewell Forgings Pty Ltd* (1995) 17 ACSR 602, 13 ACLC 1,172, *Re Vanfox Pty Ltd* (1994) 13 ACSR 209, 12 ACLC 357. However, the application for extension was refused in *Watson v Uniframes Ltd* (1995) 13 ACLC 609, *Re Bernsteen Pty Ltd and Newmore Pty Ltd* (1995) 13 ACLC 1,608.

¹⁸⁰ Proposal 6.

¹⁸¹ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

Recommendation 8. The court's power to extend the convening period should be exercisable on an application made after the convening period has ended only where there would otherwise be substantial injustice to creditors. The court should have regard to the administrator's conduct when considering the costs of that application.

Adjournment of the major meeting

2.82 The major meeting of creditors can be adjourned from time to time, provided that the adjourned meeting will not take place more than 60 days after the first day on which the meeting was held.¹⁸² The court has no specific power to permit the major meeting to be adjourned for more than 60 days. However, the court may make an order extending the period of time for adjournment under its general powers.¹⁸³

2.83 One commentator has argued that the courts should no longer have a specific or a general power to extend the creditors' deliberation period. This restriction would be consistent with the Law Reform Commission's principle that the corporate voluntary administration procedure should be efficient and expeditious.¹⁸⁴ A contrary view is that creditors or the committee of creditors, as well as the court, should be able to extend the period.

2.84 The Legal Committee supports the principle that administrations should be concluded expeditiously.¹⁸⁵ The Committee in its Discussion Paper proposed that the period by which creditors can adjourn the major meeting should be reduced from the current 60 days (effectively about 8½ weeks) to 30 business days (effectively 6 weeks) after the first day on which the meeting is held.¹⁸⁶ This shorter time should generally be adequate to conclude an administration.

2.85 Notwithstanding the need for expedition, the Legal Committee acknowledged that there may be circumstances in complex administrations where it is reasonable for creditors to adjourn a meeting for more than 30 business days. The Committee proposed that this longer adjournment should be possible with the leave of the court.

2.86 Some submissions supported the proposed reduction in the maximum time for adjournments.¹⁸⁷

¹⁸² s 439B(2), Corp Regs 5.6.16(4A), 5.6.18(1A).

¹⁸³ ss 447A, 1322(4)(d). *Cawthorn v Keira Constructions Pty Ltd* (1994) 13 ACSR 337, 12 ACLC 396, *Re Taylor* (1995) 16 ACSR 774, 13 ACLC 313, *Re Double V Marketing Pty Ltd (in admin)* (1995) 16 ACSR 498, *Re LOCM Pty Ltd (admin apptd)* (1997) 25 ACSR 349, 15 ACLC 1,576. The Law Reform Commission did not propose a restriction on the time for which meetings could be adjourned: ALRC 45, vol 2, s VA28(4). However, the maximum time for which the moratorium was to last was 35 days, unless the court allowed a longer period: ALRC 45, vol 2, s VA22(7).

¹⁸⁴ J O'Donovan, "The Harmer Reforms: Arranged Marriages and Extended Honeymoons" (1995) 8 *Corporate and Business Law Journal* 101 at 116, J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,515.

¹⁸⁵ ALRC 45, vol 1, para 54; Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 507.

¹⁸⁶ Proposal 7.

¹⁸⁷ Australian Credit Forum *Submission*, The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission* (except the Australian Institute of Company Directors), Westpac *Submission*. One commentator who

2.87 Other submissions disagreed with any time reduction,¹⁸⁸ for the following reasons.

- The current time allowed is necessary, particularly in large complex administrations.¹⁸⁹
- This matter should be determined by creditors.¹⁹⁰
- The 60 day maximum time has enabled some companies to continue trading under administration with a view to being sold as a going concern.¹⁹¹
- The proposal to decrease the maximum adjournment period could increase the need to make applications to the court.¹⁹²

2.88 The Legal Committee recognises that adjournments longer than the proposed 30 business days may sometimes be necessary, but regards the requirement to apply to the court in those instances as a useful safeguard against unnecessary delay.¹⁹³

2.89 One submission suggested that the prior approval of creditors be required as a condition of the administrator's application to the court for an extension of the maximum period within which creditors may adjourn the meeting.¹⁹⁴ The Legal Committee disagrees. Creditors should be entitled to make a binding decision at the meeting whether, and for how long, it should be adjourned. This would not be possible for an adjournment past the permitted period if the administrator had to seek subsequent court approval for that adjournment. It is preferable to permit an administrator to seek prior court approval for creditors to adjourn the meeting.

Recommendation 9. The current 60 day maximum time by which creditors can adjourn meetings should be reduced to 30 business days after the first day on which the meeting is held. However, the court should be given a specific power to permit

supports reducing the time for adjournment without court approval has proposed a 20, rather than 30, business day time limit: C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 23.

¹⁸⁸ Australian Institute of Credit Management *Submission*, Ernst & Young *Submission*, Horwath *Submission*, KPMG *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*. See also MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91]. Some of the submissions that disagreed with the Discussion Paper Proposal 7 suggested instead a 45 business day (63 calendar day) limit on adjournments: Ernst & Young *Submission*, KPMG *Submission*.

¹⁸⁹ Australian Institute of Credit Management *Submission*.

¹⁹⁰ Australian Institute of Credit Management *Submission*, Ernst & Young *Submission*, Law Council of Australia *Submission*.

¹⁹¹ Geoff McDonald *Submission*.

¹⁹² Geoff McDonald *Submission*. See also MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91].

¹⁹³ The ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 2.112(e) notes the use of the voluntary administration process in a variety of ways as a stalling tactic. The ability to adjourn the second meeting of creditors for up to 60 days, sometimes through a series of adjourned meetings, can lead to creditors becoming frustrated with the delay and losing interest in the matter.

¹⁹⁴ Ernst & Young *Submission*.

creditors to adjourn meetings to a date after that period, on application by the administrator.

Directors to attend creditors' meetings

2.90 There is no specific requirement for the directors of a company under administration to attend creditors' meetings.¹⁹⁵ By contrast, debtors must attend creditors' meetings convened under Part X of the Bankruptcy Act.¹⁹⁶ Also, directors must appoint a representative to attend the creditors' meeting in a creditors' voluntary winding up.¹⁹⁷

2.91 Company directors who hope to continue business under a deed of company arrangement would probably, as a matter of commercial necessity, either all attend in person or appoint one of their number as a representative to persuade the creditors' meeting to accept the deed. Nevertheless, the Legal Committee in its Discussion Paper proposed that all directors should be required to attend creditors' meetings to give creditors the opportunity to question them about their conduct of the company's affairs. A director could be excused from attending only on showing reasonable cause for failure to attend (for instance, illness or other involuntary inability to attend) or with the approval of the administrator or creditors. However, given the common law privilege against self-incrimination, the Committee did not consider that any director should be obliged to answer questions.¹⁹⁸

2.92 Some submissions supported this proposal,¹⁹⁹ with suggested modifications.

- Some submissions considered that the object of the proposal might equally be achieved if only some directors were required to attend the meetings.²⁰⁰
- Some submissions suggested that the requirement might be for the "principal director" to attend.²⁰¹ However, one submission that supported the requirement for all directors to attend pointed to the difficulty of determining the "principal" director.²⁰²

¹⁹⁵ There is a general requirement for a director of a company under administration to attend on the administrator and give the administrator such information about the company's business, property, affairs and financial circumstances as the administrator reasonably requires: s 438B(3).

¹⁹⁶ Bankruptcy Act s 195.

¹⁹⁷ s 497(5)(b).

¹⁹⁸ Proposal 5.

¹⁹⁹ Allen Allen & Hemsley for QIDC *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission* (majority view: the Law Council disagreed), Westpac *Submission*. See also MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91].

²⁰⁰ Richard Fisher *Submission*, VALRC *Submission* (general consensus view).

²⁰¹ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission* (some members of these two groups favoured all directors attending), VALRC *Submission* (this submission favoured permitting another director to substitute for the principal director).

²⁰² Ernst & Young *Submission*.

- Some submissions considered that directors should be obliged to answer questions put to them by creditors or the administrator, subject only to the privilege against self-incrimination.²⁰³
- One submission considered that directors should be required to attend the major meeting, but not the first meeting, in view of the limited purpose of the first meeting.²⁰⁴ By contrast, another submission said that directors should be required to attend the first meeting, but subsequent meetings only if requested by the administrator.²⁰⁵

2.93 Some submissions opposed the proposal,²⁰⁶ for the following reasons.

- There is no evidence of a director refusing to attend a creditors' meeting, or the director's absence having had any adverse impact on the outcome of the meeting, or the administration generally. It is in the interests of the directors that a proposal acceptable to the creditors is promulgated.²⁰⁷
Legal Committee response. On this view, the Legal Committee's proposal would merely reinforce current practice.
- A director should not be required to attend where the administrator has been appointed by a chargeholder.²⁰⁸
Legal Committee response. It is important for directors to account for their actions, regardless of who has appointed the administrator.
- Requiring attendance without requiring directors to answer questions defeats the purpose of the meeting and the reason for enforcing the directors' attendance.²⁰⁹
Legal Committee response. Given the important role creditors play in a voluntary administration, directors would be likely to answer creditors' questions, except where the answers would incriminate them.
- Directors are not required to attend liquidation meetings.²¹⁰

²⁰³ Allen Allen & Hemsley for QIDC *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*. However, the VALRC *Submission* also expressed concern that "directors, during questioning, may make admissions unknowingly which could be to their detriment in subsequent proceedings". C Hinchin, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 23 considers that directors should not be obliged to answer questions concerning their personal liability for possible breach of duty.

²⁰⁴ Australian Credit Forum *Submission*.

²⁰⁵ Westpac *Submission*.

²⁰⁶ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*. See also C Hinchin, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 23.

²⁰⁷ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

²⁰⁸ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

²⁰⁹ Australian Institute of Credit Management *Submission*.

²¹⁰ Australian Institute of Credit Management *Submission*.

- The proposal is likely to detract from the intended purpose of the first meeting.²¹¹
- Creditors may be confused about whether the administrator or the company's directors control the company.²¹²
- The administrator may wish to report to creditors on proposed legal action against the company's directors.²¹³
Legal Committee response. Creditors should have the power to direct attending directors to leave the meeting for all or part of the remainder of that meeting.
- Creditors would probably be reluctant to give the administrator extremely useful information if the directors attended the meeting.²¹⁴
Legal Committee response. Giving creditors the power to direct attending directors to leave the meeting for all or part of the remainder of that meeting would avoid this problem.
- The proposal could prove a disincentive to directors appointing an administrator in the first place.²¹⁵

2.94 The Legal Committee does not consider that these objections outweigh the advantages of giving creditors access to the directors.

Recommendation 10. All the directors of a company under administration should be required to attend creditors' meetings, but should not be obliged to answer questions. A director should only be excused from attendance if:

- the director can show reasonable cause for failure to attend, or
- the director's absence has been approved by the administrator or by a resolution of the creditors.

In addition, creditors at each meeting should have the power to direct attending directors to leave the meeting for all or part of the remainder of that meeting.

Discussion of general business at creditors' meetings

2.95 The Legal Committee in its Discussion Paper considered whether the legislation should be amended to permit creditors to discuss "any business that is, in the opinion of the administrator, appropriate and relevant to the company's affairs".²¹⁶ The Committee considered that, given the breadth of the material to be covered in the administrator's report to creditors, which creditors will discuss at their meeting, there is no need for an additional provision permitting creditors to discuss general business.

²¹¹ Law Council of Australia *Submission*. For the purposes of the first meeting, see s 436E(1), (4).

²¹² Law Council of Australia *Submission*.

²¹³ Law Council of Australia *Submission*.

²¹⁴ Geoff McDonald *Submission*.

²¹⁵ Geoff McDonald *Submission*, Law Council of Australia *Submission*.

²¹⁶ At 36.

2.96 Two submissions commented on this matter. One supported the Legal Committee's view.²¹⁷ The other was concerned to ensure that creditors have the right to ask the directors and the administrator any questions which may be appropriate and relevant to the company's affairs.²¹⁸

2.97 The Legal Committee's recommendation (Recommendation 10, above) that directors be required to attend creditors' meetings would give the creditors the opportunity to ask questions, though the directors would not be compelled to answer the questions.

Approving and executing the deed of company arrangement

2.98 Currently, the administrator must circulate a summary of any proposed draft deed of company arrangement before the major meeting of creditors.²¹⁹ The Legal Committee favours retention of this requirement.

2.99 The Legal Committee in its Discussion Paper considered whether the administrator should also be required to table a copy of the draft deed at the meeting and make it available for inspection at that meeting so that creditors are aware of its specific terms before they vote to accept it.²²⁰ The Committee favoured a full draft deed being sent to creditors before the meeting, or provided at the meeting, where possible.²²¹ However, a legislative requirement to either effect may be too restrictive, as:

- a proposal for dealing with the company's insolvency is often not settled before the major meeting
- there may be several alternative proposals for creditors to consider
- a proposal may be changed or renegotiated at that meeting
- it may be unclear whether all creditors will support the proposal for a deed of company arrangement.

2.100 The Legal Committee considered that the legislation should distinguish between:

²¹⁷ Geoff McDonald *Submission*.

²¹⁸ Australian Credit Forum *Submission*.

²¹⁹ s 439A(4)(c).

²²⁰ At 33-34. There is currently no requirement for administrators to submit a completed deed of company arrangement to creditors at the major meeting: *Deputy Commissioner of Taxation (Cth) v Comcorp Australia Ltd* (1995) 13 ACLC 1,671, upheld on appeal to the Full Federal Court in *Deputy Commissioner of Taxation (Cth) v Comcorp Australia Ltd* (1996) 21 ACSR 590, 14 ACLC 1,616.

²²¹ J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,549 points out that: "It is advisable in some cases for the administrator to have prepared a draft deed of company arrangement before or during the course of the second meeting of creditors. If the creditors vote upon specific provisions in a draft deed there is less scope for uncertainty and ambiguity in reducing the terms of the creditors' resolution to form." Making the draft deed available may also reduce the likelihood that it will be attacked by creditors for being different from the proposal that they approved: P Lynch, "Drafting a Deed of Company Arrangement" (1995) 3 *Insolvency Law Journal* 115 at 126.

- the requirements where a full draft deed has been previously sent to creditors, or provided at the major meeting, and creditors have fully approved the deed (that is, either without amendment or subject to amendments which the creditors consider do not require their further inspection of the deed), and
- the requirements where a draft deed must be prepared after the major meeting, or the creditors have not fully approved the draft deed at the major meeting.

Draft deed fully approved at the major meeting

2.101 The Legal Committee in its Discussion Paper proposed that a company should be required to execute the draft deed within 15 business days of its approval by creditors or such further period as the court allows on an application made by the administrator within those 15 business days.²²²

2.102 No submissions opposed this proposal.

Recommendation 11. The administrator and the company should execute a deed that is fully approved at the major meeting within 15 business days of its approval, or such further period as the court allows on application made by the administrator within those 15 business days.

Draft deed not fully approved at the major meeting

2.103 The Legal Committee in its Discussion Paper proposed that the administrator should be required to make available for inspection by creditors a copy of the draft deed, drafted in accordance with the creditors' decision at the major meeting, within 10 business days following that meeting.²²³ The court should have a power to extend this time on application by the administrator within that 10 business day period.²²⁴

2.104 The Legal Committee also proposed that creditors should have 3 business days to inspect the draft deed, once made available for inspection. The draft deed should then be executed by the administrator and the company within 2 business days following the end of the inspection period.

²²² Proposal 14. This is the current requirement: s 444B(2) (the time limit in this provision is 21 days, which is the equivalent of 15 business days). Additional time for making the draft deed available and for executing the deed may be necessary because, for instance, the administrator does not have sufficient time to formulate the necessary cash flow projections to estimate the timing of dividend payments to creditors: M Rose & LJ Law, "Voluntary Administrations: Will They Work?" (1995) 3 *Insolvency Law Journal* 11 at 22.

²²³ Strictly, the deed administrator takes office once creditors vote to accept a deed, even before its formal execution: s 444A. However, for ease of reference, this report uses the term "administrator" rather than "deed administrator" in discussing the period before the deed is executed.

²²⁴ Proposal 14. The 10 business day time limit is consistent with the requirement that minutes of the major meeting be lodged with the Commission within 14 days (equivalent to 10 business days) after the end of the major meeting: Corp Reg 5.6.27(3), (6)(b). The minutes must be made available for inspection at the company's registered office or principal place of business: Corp Reg 5.6.27(4).

Submissions

2.105 Some submissions supported this proposal in its entirety.²²⁵

2.106 Several submissions suggested amendments to the proposal.

- The period for executing the deed after the end of the inspection period should be increased from 2 business days to at least 5 business days.²²⁶
Legal Committee response. The Legal Committee places great importance on expedition in completing voluntary administrations. In many, if not most, administrations, the proposed 2 business day period should suffice. However, there may be some circumstances in complex administrations where the draft deed needs considerable amendment in the light of comments made by creditors during the inspection period. The Committee therefore proposes that the court should have a power to extend the 2 business day period for executing the deed on application by the administrator within that period.
- Creditors should have a power to extend either the 10 business days for preparing the draft deed or the 2 business days for executing the draft deed.²²⁷
Legal Committee response. The option of seeking creditor approval may provide the administrator with an easier method of obtaining an extension than going to court. However, the Legal Committee does not agree that creditors should have a power to extend these time periods. Once the creditors have resolved at the major meeting to accept the deed, there are no more stipulated creditors' meetings to provide a ready forum for the administrator to seek their consent for any time extension. Permitting the administrator to call a creditors' meeting for this purpose may impose an unnecessary additional burden on creditors who may already have devoted considerable time to protecting their rights.
- There should be greater prescription of the contents of the proposed deed and its impact on creditors. For instance, the administrator could be required to outline the differences between the deed and the prescribed provisions in Schedule 8A.²²⁸
Legal Committee response. The general requirement for administrators to set out details of proposed deeds²²⁹ is sufficient. There should not be any

²²⁵ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, Ernst & Young *Submission* (which noted that it is generally not possible to have a fully drafted deed available to send out to creditors at the time of convening the meeting).

²²⁶ Allen Allen & Hemsley for QIDC *Submission*.

²²⁷ Westpac *Submission*.

²²⁸ Ernst & Young *Submission*. See also C Hinchin, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 19-20.

²²⁹ s 439A(4)(c).

more detailed prescription of the content of administrators' summaries of proposed deeds of company arrangement.

2.107 One submission saw little point in creditors having a right to inspect the draft deed without their also having the right to comment on its content and the administrator having an obligation, and additional time, to take any comments into account.²³⁰ The Legal Committee agrees that the administrator should be required to take into account any comments by creditors. It notes that the purpose of the proposed inspection period is to allow creditors to ensure that the draft deed reflects their resolution at the major meeting and to put their views to the administrator on possible amendments to rectify any apparent inconsistencies.

2.108 The Legal Committee considers, however, that, while administrators have a duty to take into account all comments by creditors, an administrator should retain the final discretion over the content of the deed and should execute it within the specified two business day period following the end of the inspection period, unless the court has granted an extension. This approach is necessary to avoid delaying the execution process.

2.109 The administrator should be required to advise creditors at the major meeting that while they are entitled to inspect the draft deed and provide comments to the administrator, they cannot assume that the final executed deed will necessarily be in accordance with the draft document. The administrator's final responsibility for the form of the deed should be drawn to their attention. However, creditors would retain their current right to apply to the court for termination of a deed of company arrangement where they can show that the deed does not reflect their resolution at the major meeting.²³¹

2.110 Some submissions opposed the proposal in its entirety.²³² One of these respondents gave the following arguments in opposition to the Legal Committee's proposal.²³³

- . It is the administrator's duty to incorporate the creditors' resolution into the deed.
Legal Committee response. The Legal Committee agrees that the responsibility for the final form of the deed of company arrangement must remain with the administrator. However, the proposed inspection procedure may allow creditors to assist the administrator in carrying out that task.
- . The creditors can have recourse to the court if the deed does not reflect their resolution.
Legal Committee response. The inspection process may assist administrators in improving the draft and resolving possible disputes with creditors as to its contents without resort to the courts.

²³⁰ Australian Bankers' Association *Submission*.

²³¹ s 445D.

²³² The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

²³³ VALRC *Submission*.

- To have an avenue for creditors or any individual creditor to delay or attempt to amend the deed or the intention of the deed is contrary to the intention of the legislation and could be highly disruptive. Any change to the creditors' resolution should not be implemented without a further resolution of creditors.

Legal Committee response. The Legal Committee's proposal would not delay the deed. The time limits require execution within 15 business days after the creditors' decision (subject to any extension granted by the court). Also, creditors could not amend the deed or its intention. Rather, the purpose of the Legal Committee's proposal is to help ensure that the deed is in accordance with the creditors' original resolution. The proposal would not of itself allow changes to that resolution. The administrator has the ultimate responsibility to ensure that the deed reflects the creditors' resolution.

- There has been no case law suggesting that a creditors' resolution has not been properly documented and executed by the administrator.

Legal Committee response. A recent ASC Research Paper has found evidence that some administrators have not prepared a deed of company arrangement that accurately reflects the agreement reached by creditors at the major meeting.²³⁴

- Providing individual creditors with the opportunity to examine and comment on the draft deed may mean that individual, financially powerful creditors can place undue pressure on the administrator to amend the draft deed, possibly to the detriment of creditors as a whole.

Legal Committee response. The Legal Committee proposal would permit all creditors to inspect and comment on the draft deed. Also, the ultimate responsibility for drafting and finalising the deed rests with the administrator, whose task would be to ensure that the final deed fully and accurately reflects the decisions taken by the creditors at the major meeting. The legislation relies heavily on the integrity and impartiality of the administrator, who has an overall duty to act in the interests of all, not merely some, creditors. Any administrators who fail to act in this way are

²³⁴ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 1.206(b), 1.302(b), 7.305. The primary issues for creditors dealing with insolvent companies under administration are:

- what amount will be available to them under the deed
- when will the money be received, and
- what safeguards exist to ensure compliance with the deed and protection of their interests.

The ASC Research Paper says that creditors usually discuss these issues at the major meeting in precise terms, but administrators are not reflecting that precision when preparing the deed. At times, the requirements of creditors are being omitted and/or discretions incorporated which were not discussed or approved by creditors. The discretions related to matters such as:

- the timing of the receipt of money into the deed fund
- the frequency of meetings of the creditors or the committee of creditors
- reporting and monitoring requirements during the deed period.

Practitioners then use these omissions and/or discretions to justify not taking action on a timely basis when defaults occur in the critical areas.

directly accountable under the legislation and the general law and exposed to disciplinary action under the statutory licensing regime.

- There would be additional, probably substantial, costs in complying with any amendment triggered by the proposal.
Legal Committee response. Substantial additional costs are unlikely, given that the amendments would be directed at aligning the deed with the original resolution of creditors.

Legal Committee view

2.111 The Legal Committee adheres to its original proposal, which was intended to give creditors a mechanism to:

- ensure that a deed is in accordance with their resolution, given that it is not possible to require that creditors have a draft deed before the major meeting in all cases
- resolve any disputes about the content of the deed without going to court, except where absolutely necessary.

2.112 The administrator should have ultimate responsibility for drafting the deed in accordance with the creditors' agreement at the major meeting. Creditors should be informed at that meeting:

- of their rights to inspect and comment on the foreshadowed draft deed
- that the final executed deed may not be in accordance with the draft document (for instance, where the administrator becomes aware of an inconsistency between the creditors' resolution and the draft deed during or after the creditor inspection period).

Recommendation 12. Where a deed is not fully approved at the major meeting, the administrator must draft a deed within 10 business days following the creditors' decision at that meeting. The court should have a power to extend this time on application by the administrator within that 10 business day period. Creditors should thereafter have 3 business days to inspect the draft deed. The administrator and the company should execute the deed within 2 business days following the end of the inspection period. However, the court should have a power to extend that 2 business day period for executing the deed on application by the administrator within that period.

Creditors should be informed at the major meeting:

- . of their rights to inspect and comment on the draft deed
- . that the final executed deed may not be in accordance with the draft document and that the administrator retains the ultimate responsibility for drafting the deed.

Chapter 3. Voting at creditors' meetings

This Chapter examines the majorities that should be required to pass a resolution at creditors' meetings, proxy voting and the voting rights of related parties, secured creditors, employees and property owners. It also discusses the disclosure of voting arrangements.

Dual voting requirement

Current law

3.1 There are no voting provisions exclusively for Part 5.3A. The provisions for voting under Part 5.3A are generally the same as for liquidations.²³⁵ Hence, the following rules apply to creditors' meetings held under Part 5.3A.

- The administrator chairs meetings that he or she has called.²³⁶
- A poll can be carried on the voices.²³⁷
- However, the following may demand a poll, before or on the declaration of the result of the voices:
 - the chairman, or
 - at least 2 persons present in person, by proxy or by attorney and entitled to vote at the meeting, or
 - a person present in person, by proxy or by attorney and representing not less than 10% of the total voting rights of all the persons entitled to vote at the meeting.²³⁸
- A resolution at a creditors' meeting is carried if:
 - a majority by number of the creditors voting (whether in person, by attorney or by proxy) (*majority by number*) vote in favour of the resolution, and
 - a majority by value of the creditors voting (*majority by value*) (that is, creditors the value of whose debts is more than half the total debts owed to all the creditors voting, whether in person, by proxy or by attorney) vote in favour of the resolution.²³⁹
- A resolution at a creditors' meeting is not carried if:
 - a majority by number of creditors vote against the resolution, and
 - a majority by value of creditors vote against the resolution.²⁴⁰
- If a meeting does not reach a result under the previous two steps (given that for a resolution to be either carried or not carried requires a vote for or

²³⁵ Corp Reg 5.6.11(2) applies Corp Regs 5.6.12 to 5.6.36A to the convening and conduct of, and voting at, meetings held under Part 5.3A.

²³⁶ Corp Reg 5.6.17(1).

²³⁷ Corp Reg 5.6.19(1).

²³⁸ Corp Reg 5.6.19(1).

²³⁹ Corp Reg 5.6.21(2).

²⁴⁰ Corp Reg 5.6.21(3). The Law Reform Commission recommended that voting in an insolvency administration be by simple majority in number of all creditors present and voting either in person, by proxy, by attorney or by such other means as may be permitted (for instance, by an "absentee" vote), but that if two or more creditors so request, voting be by majority in number and value: ALRC 45, vol 1, para 579.

against the resolution, respectively, by both majorities), the administrator may exercise a casting vote.²⁴¹

- Where a resolution is passed or defeated on the casting vote of the administrator, a person who has voted the opposite way in some capacity (or on whose behalf someone else has voted the opposite way) can apply to the court to vary or set aside the resolution.²⁴²

3.2 The only difference between general voting rules and those applying in voluntary administrations is that under Part 5.3A, a secured creditor can vote for the full amount, rather than the net amount, of its debt.²⁴³

Problems with the current law

3.3 The main problems with the current voting rules lie in:

- the possible conflict between the majority by number and the majority by value requirements (given that both majorities must be obtained either to carry or not carry a resolution), and
- the provision for the administrator's casting vote to resolve this conflict, particularly on questions that affect the administrator (for instance, the administrator's remuneration or whether to replace the administrator²⁴⁴).

Legal Committee proposal: majority by value only

²⁴¹ Corp Reg 5.6.21(4). The Explanatory Memorandum to the Corporations Regulations (Amendment) Statutory Rules 1993, No 135 states (at para 111) that exercise of a casting vote would be most appropriate where:

- "the creditors with a majority in value have such an overwhelming interest that it is inappropriate to allow a majority in number, who do not have the same monetary interest, to carry the day, or vice versa; or
- "the inability to arrive at any decision, because of continuing deadlocks, affects the welfare of the company concerned".

²⁴² ss 600B, 600C. The Law Reform Commission recommended that if a vote according to majority in number and value results in a deadlock, there be provision for an application to the court by the relevant insolvency administrator or by a dissatisfied creditor for a resolution of the conflict: ALRC 45, vol 1, para 579. However, the Federal Parliament considered that this creditors' right of appeal to the court in the first instance to resolve a deadlock would erode funds available to creditors: Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 1200, Explanatory Memorandum to the Corporations Regulations (Amendment) Statutory Rules 1993, No 135 para 96.

²⁴³ The provision for a secured creditor to vote for the net amount of the debt (Corp Reg 5.6.24(2)) does not apply to a meeting of creditors under Part 5.3A: Corp Reg 5.6.24(4).

²⁴⁴ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 1.210, 7.502 noted cases in the files reviewed when administrators exercised the casting vote in favour of their own interests in the case of removal of the administrator (s 436E(4)), approval of the administrator's remuneration (s 449E), and approval of a deed of company arrangement. The result of the above is that it is virtually impossible in most cases for external third party creditors to influence the voting on these matters. Challenging the results of voting influenced by related party votes or the use of the casting vote (Part 5.9 Div 3) imposes a considerable burden on the applicant.

The court in *Re Ballan Pty Ltd (admin apptd)* (1994) 12 ACSR 605, 12 ACLC 166 considered that Corp Reg 5.6.17(1)(c), which requires the administrator to chair a meeting, even where a motion concerning the administrator's continuance in office is being considered, was inconsistent with the rules of procedural fairness.

3.4 The Legal Committee in its Discussion Paper proposed that the voting formula should be changed so that resolutions can be either passed or rejected by creditors representing a majority in value of the company's debt, regardless of their number.²⁴⁵ This would give the creditors with the greatest financial interest the power to determine the outcome of an administration. In consequence, there would no longer be any need for the administrator to have a casting vote.²⁴⁶

Submissions

3.5 A few submissions agreed with this majority by value proposal.²⁴⁷

3.6 Many submissions disagreed,²⁴⁸ for the following reasons.

- The proposal fails to acknowledge adequately the small creditors, who are often the worst affected (even to the point of bankruptcy) by the insolvency of their debtors and the least able to protect their interests, for instance, through litigation.²⁴⁹
- It would undermine the confidence of the commercial community in the voluntary administration procedure.²⁵⁰
- The proposal is contrary to the view of the Law Reform Commission that a majority in value voting procedure would provide no safeguard to ensure that the majority is a representative proportion of creditors. It would also be difficult to apply in the case of contingent or unascertained creditors.²⁵¹

²⁴⁵ Proposal 40.

²⁴⁶ This change would also remove the need for the court powers to review resolutions passed or lost on the casting votes of administrators (ss 600B, 600C). J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,524 has strongly criticised the casting vote: "If the casting vote is exercised in favour of the resolution it is carried, even if a creditor with a majority in value of the corporation's debts voted against the resolution. This is an extraordinary interference with the rights of such a creditor and it is a gross distortion of the general conception of a casting vote, which is normally used to resolve deadlocks."

²⁴⁷ Australian Credit Forum *Submission*, Westpac *Submission*. See also J Gibbons & G Green, *Achieving a "fair and reasonable" outcome with voluntary administration*, Paper delivered to the IIR Corporate Insolvency Conference, Sydney 31 October 1996 at 18.

²⁴⁸ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*.

²⁴⁹ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

²⁵⁰ The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁵¹ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*. The Law Reform Commission opposed a majority in value only voting criterion: ALRC 45, vol 1, para 573. The Commission considered that this criterion could be difficult to apply to contingent or unascertained creditors and, if used for all purposes, would require a more complex calculation even for less important decisions. However, the Commission recommended that voting be by majority in number and value if two or more creditors so request: para 579. The problems of determining the value of debts owed to contingent or unascertained creditors may therefore still arise under the Commission's recommendation.

- The interests of the major creditors in value will not always be identical to the interests of the company. In fact, they will often be contrary to the interests of the company.²⁵²
- Though there have been isolated problems in practice, there has been no difficulty significant enough to justify a fundamental change in the basic method of voting at meetings.²⁵³
- The proposal would permit a large creditor to force a company into liquidation when it would be in the interests of all other parties to accept a proposal.²⁵⁴
- A large creditor which has received payment that would be deemed a preference might force adoption of a weak proposal to avoid a liquidator's action to recover the preference.²⁵⁵
- The collective votes of employees might not carry much weight in terms of value. If numbers of votes were to be disregarded, these employees would be disenfranchised.²⁵⁶
- Many large creditors, such as banks, have security over the assets of the company and over the assets of other persons, yet are allowed to vote for the full amount of their debts.²⁵⁷ These creditors may have little or nothing at stake (certainly by comparison with small unsecured creditors), yet could dominate the voting at creditors' meetings.²⁵⁸
- A large creditor may have ulterior motives for voting in a particular way at a meeting. For instance, the creditor might vote to liquidate the company to eliminate a competitor.²⁵⁹
- A substantial "creditor" whose debt is only contingent might determine the fate of the company even where that creditor's proof of debt, after closer investigation, is not admitted to proof.²⁶⁰
- The proposal is an over-reaction if it is intended to deal with stacking of creditors' meetings with friends and relatives. The current provision for challenging resolutions whose outcome was determined by the votes of related party creditors²⁶¹ is an adequate solution to this problem.²⁶²

²⁵² The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁵³ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁵⁴ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁵⁵ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁵⁶ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

²⁵⁷ reg 5.6.24(4). The Legal Committee recommends that secured creditors retain the right to vote for the full amount of their debts: Recommendation 16, post.

²⁵⁸ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

²⁵⁹ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁶⁰ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁶¹ s 600A. The Legal Committee recommends that this provision remain: Recommendation 14, post.

- Any problem with the conduct of meetings could be dealt with by an appropriate body, such as the Commission, sending delegates to observe them. There is an analogous procedure for meetings of creditors under Part X of the Bankruptcy Act 1966. Representatives of the Insolvency and Trustee Service Australia can take part in meetings of creditors called to consider proposals by debtors.²⁶³
- The proposal could result in the vast majority of creditors (who are typically small to medium enterprises) being unable to benefit from a commercially acceptable proposal and being left with a liquidation.²⁶⁴

3.7 One respondent, while generally favouring the current law, raised for consideration a range of policy options for voting on the appointment and replacement of the administrator.²⁶⁵ It considered and rejected a number of voting options.

- The incumbent administrator could be required to carry both numbers and value. If there was a deadlock, the alternative nominee should be appointed.
Problem with this approach. The alternative nominee, if appointed, would have been appointed by default.
- Numbers should prevail over value, on the basis that those creditors who attend, either in person or by proxy, have the highest declared interest.
Problems with this approach. Numbers might be manipulated by using employee and related party votes. In addition, secured creditors would be more likely to appoint a receiver if numbers were to prevail over value.
- The incumbent administrator should step aside if the vote is deadlocked, with the meeting to elect a new chairman who would have the casting vote.
Problem with this approach. The voting on the election of the alternative chairman might also be deadlocked.

²⁶² The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁶³ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

²⁶⁴ Australian Institute of Credit Management *Submission*.

²⁶⁵ VALRC *Submission*. VALRC did not favour a different voting system for determining the administrator's remuneration, as "a well advised administrator would consider carefully the appropriateness of exercising a casting vote in favour of a resolution approving his or her remuneration without seeking court approval under section 449E(1)(b)".

- A majority in value should prevail, subject to a threshold, say 75%, being achieved.
Problem with this approach. Any threshold, whether 75%, 66.66% or some other threshold, would be arbitrary.

Legal Committee view

3.8 Taking into account the objections in submissions to a majority by value only voting requirement, the absence of evidence of widespread abuse and the difficulties in devising any other voting formula, the Legal Committee favours retention of the current law on voting (namely majority in value and majority in number required to either carry or not carry a resolution, with any deadlock to be broken by the casting vote of the administrator).²⁶⁶ In particular, the Legal Committee accepts the arguments in submissions that permitting resolutions to be carried by the votes of a majority in value only could create scope for abuse (for instance, structuring deeds to benefit these creditors unfairly).

3.9 The Legal Committee has also considered two alternative proposals:

- to require a majority by number and a majority by value in all cases, with no provision for a casting vote,²⁶⁷ or
- permitting a majority in value only where the votes of related creditors are not decisive (that is, the majority will remain even where the votes of related creditors are disregarded).²⁶⁸

The Legal Committee does not favour either of these suggestions. The first option could make it too difficult to have proposals approved and could consequently thwart the policy of the voluntary administration provisions. The second option does not overcome all the problems identified with any majority in value voting requirement.²⁶⁹

Restrictions or guidelines on exercise of casting vote

3.10 Some submissions suggested that guidelines could be introduced to assist an administrator so that there is consistency and predictability in the way casting votes are exercised.²⁷⁰

3.11 One submission suggested that the administrator's exercise of the casting vote could be subject to restrictions which recognise the interests of those creditors with a majority in value, for instance by requiring the chairman to exercise his or her casting

²⁶⁶ The issue raised in the Legal Committee Discussion Paper whether the majority by value voting requirement should apply to all insolvency administrations (Issue 12) is therefore irrelevant.

²⁶⁷ J Gibbons & G Green, *Achieving a "fair and reasonable" outcome with voluntary administration*, Paper delivered to the IIR Corporate Insolvency Conference, Sydney 31 October 1996 at 18.

²⁶⁸ MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91].

²⁶⁹ para 3.6, *supra*.

²⁷⁰ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Robert MH Cole & Co *Submission*.

vote in the same way as the majority in value votes if he or she is directly or indirectly financially interested in the outcome.²⁷¹ The respondent suggested that this would better protect the integrity of the administrator, for instance, by resolving possible conflict of interest problems arising from proposals to replace an administrator or adopt a deed of company arrangement with the administrator as deed administrator.

3.12 The Legal Committee does not support a requirement for those chairing a meeting to exercise their casting vote in the same way as the majority in value if they are directly or indirectly financially interested in the outcome. Given that administrators generally have this financial interest, the majority in value would almost always prevail.

3.13 The Legal Committee has also considered, but rejected, the idea of having an independent chairman for meetings.²⁷² The chairman would have to be a professional person who may be unwilling to exercise the casting vote without having a detailed knowledge of the affairs of the company, a task that the administrator has been engaged to perform. An independent chairman's involvement may thus lead to additional cost and potential delays.

Recommendation 13. The current dual majority by value and number voting requirement, with the administrator having a casting vote to resolve any deadlock, should be retained.

Related creditor voting and other grounds for creditor objections

Current law

3.14 The court may, on application by a creditor of a company, make orders where the outcome of voting at a creditors' meeting under the voluntary administration provisions (including the adoption of a deed of company arrangement) has been determined by related creditors.²⁷³ This power is exercisable if passing, or failing to pass, the resolution:

- is contrary to the interests of the creditors as a whole, or

²⁷¹ Ernst & Young *Submission*.

²⁷² ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 7.501-7.502.

²⁷³ A related creditor is a person who was a related entity and a creditor when the vote was cast: s 600A(3). A "related entity" is:

- a promoter of the company
- a director or member of the company or of a related body corporate
- a beneficiary under a trust of which the company is or has been a trustee
- a relative, or de facto spouse, of any of those persons
- a relative of a spouse, or of a de facto spouse, of any of those persons
- a related body corporate of the company
- a body corporate one of whose directors is also a director of the company
- a trustee of a trust under which another related entity is a beneficiary (s 9).

- has prejudiced, or is reasonably likely to prejudice, the interests of the other creditors to an extent that is unreasonable having regard to:
 - the benefits resulting to some or all of the related creditors from passing, or failing to pass, the resolution, and
 - the nature of the relationship between the related creditors and the company, and
 - any other relevant matter.²⁷⁴

3.15 The court may:

- order that a resolution that has been passed be set aside
- order that a proposed resolution be considered and voted on at a meeting of the creditors of the company convened and held as specified in the order
- direct that the related creditor is not, or such of the related creditors as the order specifies are not, entitled to vote on:
 - the proposed resolution, or
 - a resolution to amend or vary the proposed resolution
- make such other orders as the court thinks necessary.²⁷⁵

Legal Committee's proposal

3.16 The Legal Committee in its Discussion Paper proposed that the current power for a creditor to challenge a resolution passed on the votes of related parties should be replaced with a wider right for an aggrieved creditor to challenge resolutions carried by the votes of particular interests (for instance, where a resolution is carried by the votes of creditors who have been offered inducements to vote to accept a deed).²⁷⁶ The Legal Committee also sought submissions on whether there should be any specific legislative criteria, or any time limit, for this broader right of challenge.²⁷⁷

Submissions

3.17 Some submissions proposed that, rather than widening the grounds for a court challenge, related creditors should not be entitled to vote. They considered that the potential costs arising from the current right to challenge a resolution in the court often militate against creditors exercising that right.²⁷⁸

3.18 However, another submission rejected a limitation on related party voting rights, as it could disenfranchise creditors who have legitimate claims.²⁷⁹

²⁷⁴ s 600A(1).

²⁷⁵ s 600A(2). A court order does not invalidate anything done pursuant to a resolution before the court makes the order: s 600E. These provisions are based on ALRC 45, vol 1, para 583.

²⁷⁶ Proposal 40.

²⁷⁷ Issue 11.

²⁷⁸ Australian Finance Conference *Submission*, Westpac *Submission*. See also R King, "Voluntary Administrations: Proposals For Change" in JPG Lessing & JF Corkery, *Corporate Insolvency Law* (The Taxation and Corporate Research Centre, 1995) 91 at 100, 104.

²⁷⁹ VALRC *Submission*.

3.19 Most submissions opposed setting out any specific legislative criteria for any broader right to challenge resolutions.²⁸⁰

Legal Committee response

3.20 The Legal Committee does not support any general restriction on the voting rights of related creditors. It notes the comments in a recent ASC Research Paper that voting by related parties may overwhelm the voting of third party creditors.²⁸¹ However, related creditors are often genuine and major stakeholders.

3.21 The Legal Committee acknowledges the uncertainty that might arise if the reference to related creditors is changed to “particular interests”, as contemplated in its original proposal. It also notes the power of the court to terminate a deed if any act or omission is oppressive or unfairly prejudicial to one or more creditors.²⁸² Given this, the current provision should remain. Also, no additional legislative criteria for challenging a resolution of creditors should be set out in the legislation.

Recommendation 14. The current court power to overturn a resolution whose outcome was determined by the votes of related party creditors should remain.

Disclosure of agreements

3.22 The Legal Committee in its Discussion Paper proposed that directors and administrators should have a duty to disclose to creditors any arrangements of which they are aware for persons to vote a particular way on a proposal.²⁸³ That obligation should remain up to the time of the poll.

3.23 Some submissions supported this proposal.²⁸⁴ One of these respondents, while agreeing with the principle of disclosure, considered that the proposal required further review, as it may be difficult to prove that directors and administrators “are aware” of particular voting arrangements.²⁸⁵

3.24 Other submissions disagreed with the Legal Committee proposal,²⁸⁶ for the following reasons.

- . It is subjective and open to wide interpretation, and would impose an extremely onerous obligation.²⁸⁷

²⁸⁰ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

²⁸¹ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 7.501.

²⁸² s 445D(1)(f).

²⁸³ Proposal 41.

²⁸⁴ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, Westpac *Submission*.

²⁸⁵ Geoff McDonald *Submission*.

²⁸⁶ Horwath *Submission*, Law Council of Australia *Submission*, VALRC *Submission*.

²⁸⁷ Horwath *Submission*, VALRC *Submission*.

Legal Committee response. Various Corporations Law provisions currently impose duties on particular company officers to disclose information of which they are aware (for instance, the fundraising, takeover and continuous disclosure obligations).

- . There is no reason why the proposal should be limited to administrators and directors, and not extended to creditors.²⁸⁸

Legal Committee response. This argument supports the principle of disclosure. It merely questions whether creditors, as well as directors and administrators, should have this obligation. The Legal Committee favours the current policy of the voluntary administration provisions, which impose on directors and administrators the responsibility for giving creditors information.²⁸⁹

- . Administrators are already required to report on matters that are deemed to be of material interest to creditors.²⁹⁰

Legal Committee response. The Legal Committee considers that a more specific requirement in this regard is desirable.

- . Aggrieved creditors can seek appropriate relief from the court.²⁹¹

Legal Committee response. It is preferable to avoid the need for recourse to the courts where possible.

- . It will be difficult to define “arrangements”.²⁹²

Legal Committee response. This is a drafting issue.

3.25 The Legal Committee confirms the Discussion Paper proposal, with the addition that directors and administrators should also be required to disclose arrangements of which they are aware under which a person may become entitled to exercise a vote in a particular way.

Recommendation 15. Directors and administrators should have a duty to disclose arrangements of which they are aware and under which persons are required, or may become entitled, to vote a particular way on a proposal. That obligation should remain up to the time of the poll.

²⁸⁸ VALRC Submission.

²⁸⁹ The Legal Committee notes that the court can make orders under s 447A or s 600A setting aside or requiring reconsideration of a deed where material information affecting the votes of particular creditors was not available to all creditors: *Wood v Laser Holdings Ltd* (1996) 19 ACSR 245, 14 ACLC 801.

²⁹⁰ VALRC Submission.

²⁹¹ VALRC Submission.

²⁹² VALRC Submission.

Secured creditor voting

3.26 The Legal Committee in its Discussion Paper took the tentative view that the value of a secured creditor's debt for determining a majority by value in voluntary administrations should be the same as in other insolvency administrations, namely, the value of the debt after deducting the value of the security.²⁹³ If this change were made, secured creditors would only be able to vote for the full value of their debts by surrendering their security.

3.27 The Legal Committee noted the strong contrary view that secured creditors should be entitled to vote for the full value of their debt without surrendering their security, as companies often continue to trade after a voluntary administration ends.

3.28 Also, permitting secured creditors to vote for the full value of their debt may encourage them to participate in the administration procedure.²⁹⁴

3.29 There was some support for the Discussion Paper proposal.²⁹⁵

3.30 Most respondents strongly opposed the proposal,²⁹⁶ for the following reasons.

- Secured creditors are in a strong position to determine the future of the company. If they are to support the administration procedure, particularly through to deeds of company arrangement, the process must offer them an equally strong inducement.²⁹⁷
- As voluntary administration is a procedure for companies to reorganise their affairs efficiently and cost-effectively, it should include secured creditors in the decision-making processes.²⁹⁸
- Any dilution of secured creditors' rights would result in additional appointments of receivers during the 10 business day decision period, especially where secured creditors perceive that they may be in a relatively weak position at the major meeting, and unable to influence the terms of the deed.²⁹⁹

²⁹³ Proposal 42. This change would require the repeal of Corp Reg 5.6.24(4).

²⁹⁴ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 24, 28, 242-243.

²⁹⁵ Australian Institute of Credit Management *Submission*.

²⁹⁶ Allen Allen & Hemsley for QIDC *Submission*, Australian Bankers' Association *Submission*, ASX *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission* (unless the voting criterion were to be majority by value only), VALRC *Submission*, Westpac *Submission*.

²⁹⁷ Allen Allen & Hemsley for QIDC *Submission*.

²⁹⁸ Richard Fisher *Submission*.

²⁹⁹ Allen Allen & Hemsley for QIDC *Submission*, Australian Bankers' Association *Submission*, Ernst & Young *Submission*, Horwath *Submission*, Law Council of Australia *Submission*, VALRC *Submission*.

- The assets over which the secured creditor has security will be used by the administrator. A secured creditor should have a voting power that reflects its stake in those assets.³⁰⁰
- A deed is meant to be conducted for the benefit of creditors as a whole, whereas a liquidation is specifically aimed at making a distribution to unsecured creditors. The restriction on secured creditor voting in a liquidation should not apply to deeds of company arrangement.³⁰¹
- A secured creditor can vote to be bound by a deed of company arrangement, in contrast with Part X of the Bankruptcy Act.³⁰²
- When a company is under a deed of company arrangement, the court has a power³⁰³ to restrain a secured creditor's exercise of its rights.³⁰⁴
- The value of the security may fluctuate throughout an administration, depending on the nature of the security, and the assets secured. In those circumstances, a creditor may have greater voting power at some times than at others. A vote during a meeting could itself affect the value of one creditor's security.³⁰⁵
- The value of a secured creditor's security, however determined, may be equal to or greater than the debt secured, in which case that creditor would have no vote, even though the decision may affect the value of the security.³⁰⁶
- To require a secured creditor to rely on the value assigned to a security, for instance at the date of the appointment of the administrator, may have a serious adverse impact on that creditor's rights during the administration, without that creditor having recourse to any revaluation.³⁰⁷
- To allow an unsecured creditor with a medium debt to determine the course of the company during an administration where there is a secured creditor with a much larger debt, but a smaller net position, would be inequitable.³⁰⁸
- In a liquidation, the secured creditor ranks only for the unsecured portion of its debt, but has the ability to deal with its security. By contrast, in voluntary administration, the secured creditor may not be able to deal with its security, but may be unable to protect that security by voting.³⁰⁹

3.31 The Legal Committee recognises the force of these arguments. It no longer supports the Discussion Paper proposal, in particular as:

- if it were adopted, a secured creditor would be unable to protect its security by voting in a voluntary administration, yet may be unable to deal with that security

³⁰⁰ Australian Bankers' Association *Submission*, Ernst & Young *Submission*, Law Council of Australia *Submission*.

³⁰¹ Ernst & Young *Submission*.

³⁰² Richard Fisher *Submission*.

³⁰³ s 444F.

³⁰⁴ Richard Fisher *Submission*.

³⁰⁵ Westpac *Submission*.

³⁰⁶ Westpac *Submission*.

³⁰⁷ Westpac *Submission*.

³⁰⁸ Westpac *Submission*.

³⁰⁹ Westpac *Submission*.

- smaller creditors would be protected by the Legal Committee's decision to retain the requirement for a majority in number as well as value.³¹⁰

3.32 Also, a recent ASC Research Paper on voluntary administration found no evidence of secured creditors abusing their right to vote for the full amount of their debts.³¹¹

3.33 There is, however, an anomaly with the current secured creditor voting provision allowing secured creditors to vote for the full amount of their debts. That provision does not apply to voting under deeds of company arrangement.³¹² In these cases, secured creditors may only vote for the net amount of their debts (the value of their debt less the value of their security).³¹³ This may be a drafting oversight.

3.34 The Legal Committee considers that secured creditors should be able to vote for the full amount of their debts in meetings under a deed of company arrangement as well as while the company is under administration.

Recommendation 16. Secured creditors should be able to vote for the full amount of their debts in meetings while the company is under administration or under a deed of company arrangement.

Proxy voting by persons with a financial interest

3.35 Currently, a person must not vote any general or special proxy in favour of any resolution that would directly or indirectly place the person or the person's business partner or employer in a position to receive any remuneration out of the assets of the company, except as a creditor rateably with the other creditors of the company.³¹⁴

3.36 This current proxy voting restriction can cause considerable difficulty. For instance, an administrator cannot use the proxy of a creditor to vote in favour of a resolution approving the administrator's fees, even if that creditor specifically authorises the administrator to do so³¹⁵ (though the administrator can use a special proxy to vote in favour of his or her appointment as administrator or deed administrator or against the termination of that appointment³¹⁶). Also, an administrator would be unable to use any creditors' proxies in favour of a resolution that the company be wound up, as the administrator automatically becomes the

³¹⁰ Recommendation 13, *supra*.

³¹¹ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 1.217, 7.509.

³¹² The special rule for secured creditor voting in a voluntary administration (Corp Reg 5.6.24(4)) only applies to meetings "convened under Part 5.3A". Corp Reg 5.6.11 and ss 600A and 600B clearly distinguish between meetings under Part 5.3A and meetings under deeds of company arrangement. See P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 243.

³¹³ Corp Reg 5.6.24(2).

³¹⁴ Corp Reg 5.6.33.

³¹⁵ The same position holds for a liquidator. By contrast, trustees in bankruptcy can exercise a proxy vote on their remuneration if the instrument appointing them as proxy expressly authorises the trustee to cast the creditor's vote on such a motion: Bankruptcy Act s 64ZB(5).

³¹⁶ Corp Reg 5.6.33(3).

liquidator of the company where the creditors resolve that the company be wound up.³¹⁷

3.37 The Legal Committee proposed in its Discussion Paper that any person, including an administrator, should be permitted to vote pursuant to a proxy on any proposed resolution, provided the proxy specifically authorises that vote.³¹⁸ The restriction on general proxy voting should remain.

3.38 Most submissions supported this proposal.³¹⁹

3.39 One respondent opposed the proposal on the ground that the voluntary administration procedure and other forms of insolvency administration must not only be operated without conflict of interest, but must also be seen to do so. The exercise of a proxy by a person who is financially interested in the resolution is a basic conflict of interest. The circumstances in which a special proxy was obtained may not be known to other creditors who may presume that the proxy has been solicited.³²⁰

3.40 The Legal Committee would see force in this argument if general proxies were permitted. However, its proposal is to permit an interested party to exercise a proxy only where the proxy specifically authorises a particular vote. Presumably, parties who give special proxies exercise their own decision on the specific matters in question.

3.41 The Legal Committee confirms the proposal it made in its Discussion Paper.

Recommendation 17. Any person should be permitted to vote for or against any resolution in accordance with a special proxy, whether or not that vote is to the person's financial advantage.

³¹⁷ s 446A(4). J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,606-11,607 (see also the discussion of Corp Reg 5.6.33 at 11,520-11,521), P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 244. However, the Legal Committee is now proposing that administrators should only become the liquidator automatically if creditors resolve to wind the company up without nominating a person as liquidator (see Recommendation 54, post).

³¹⁸ Proposal 43.

³¹⁹ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

³²⁰ Ernst & Young *Submission*.

Use of general proxies

3.42 The prohibition on an administrator voting general proxies to obtain remuneration out of a company's assets³²¹ only prohibits an administrator from voting in favour of a resolution. In one recent case,³²² the court held that this restriction did not prevent an administrator voting general proxies *against* a resolution for the administrator's removal.

3.43 The Legal Committee considers that this result is anomalous.³²³ Administrators should not be permitted to vote a general proxy on resolutions in which they have an interest, whether that interest is furthered by voting for or against the resolution.³²⁴

Recommendation 18. Persons should be prohibited from voting general proxies for or against any resolution in which they are financially interested.

Voting by employees

3.44 The Legal Committee in its Discussion Paper³²⁵ considered whether employees of a company under administration should be entitled to vote on a deed, given their priority under a deed of company arrangement.³²⁶ The Committee notes an argument that currently employees are not creditors for the purposes of voluntary administration.³²⁷

3.45 One option raised in the Discussion Paper³²⁸ was that:

- employees should not be creditors for the purpose of voting on a deed of company arrangement, but
- all deeds of company arrangement should preserve employees' priority in an insolvency.

³²¹ Corp Reg 5.6.33.

³²² *Re T.C. Bricklayers Pty Ltd (admin apptd)* (Queensland Supreme Court, 29 October 1997).

³²³ The ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 7.501 states that: "There is evidence that some resolutions are being framed in a way that enables general proxy holders to vote in favour of resolutions affecting their appointment and thus their remuneration, in a manner contrary to [the intention of] reg 5.6.33".

³²⁴ The same mischief does not arise where a special proxy specifically authorises an administrator to vote in a particular way. The Legal Committee recommends that a person should be permitted to vote in favour of any resolution pursuant to a proxy that specifically authorises that vote: Recommendation 17, *supra*.

³²⁵ At 87-88.

³²⁶ s 556(1)(e), (f), (g), (h), (1A), (1B), (1C), (2), as applied to deeds of company arrangement by Corp Reg 5.3A.06, Schedule 8A, cl 4. A deed of company arrangement is taken to include prescribed provisions, as set out in Corp Reg 5.3A.06, Schedule 8A, except so far as the deed provides otherwise: s 444A(5). It is therefore possible to exclude the employees' priority from a deed, though this omission may be a ground for challenging the deed.

³²⁷ J O'Donovan, "Employees, voluntary administrations and deeds of company arrangement" (1994) 12 *Company and Securities Law Journal* 457, A Keay, "Voluntary Administrations: The Convening and Conducting of Meetings" (1996) 4 *Insolvency Law Journal* 9 at 18-19. In *Green v Giljohann* (1995) 17 ACSR 518, the court held that an employee was a creditor under a deed of company arrangement.

³²⁸ At 88.

3.46 The Legal Committee in its Discussion Paper considered that this approach may be too inflexible. There was no reason to distinguish between employees and other priority creditors. Instead, the Committee proposed that employees should continue to be permitted to vote as creditors, even if they have priority under the deed.³²⁹

3.47 Most submissions supported this proposal.³³⁰ One of these respondents³³¹ argued that a deed is meant to be for all creditors regardless of priority.

3.48 One respondent³³² opposed the proposal, for the following reasons.

- To allow employees to vote as creditors may give rise to a conflict of interest.
- Employees are priority creditors to the extent of their claims as unsecured creditors arising out of their employment.
- Employees may vote in line with their interests in continuing employment rather than as genuine creditors.

3.49 The Legal Committee maintains the view it adopted in its Discussion Paper. Particular deeds need not include a priority for employee payments.³³³ Employees should be permitted to protect their interests through a right to vote in the voluntary administration of the company that employs them. Also, creditors may have diverse reasons for exercising their votes in a particular way in a voluntary administration. The Legal Committee does not consider that the particular interests of employees should disqualify them from voting.

Recommendation 19. Employees should be permitted to vote on a deed of company arrangement as creditors, even if they have priority under that deed.

Special resolutions

3.50 The Legal Committee in its Discussion Paper considered whether there should be provision for some matters to be voted on by special resolution, for instance a resolution adopting or varying a deed of company arrangement.

3.51 The Committee did not favour requiring special resolutions for these purposes, as it would make it too difficult to have deeds accepted or varied. However, the Committee sought views on this matter.³³⁴

³²⁹ Proposal 44.

³³⁰ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

³³¹ Ernst & Young *Submission*.

³³² Westpac *Submission*.

³³³ A deed of company arrangement is taken to include prescribed provisions, as set out in Corp Reg 5.3A.06, Schedule 8A, except so far as the deed provides otherwise: s 444A(5). The s 556 priority provisions (including that for employees) in cl 4 of the prescribed provisions may therefore be excluded.

³³⁴ Issue 13.

3.52 None of the submissions that commented on this issue favoured requiring any matters to be decided by special resolution.³³⁵ One of these respondents³³⁶ said that such a requirement would:

- effectively disenfranchise the majority in value, as a higher threshold would be required to pass a resolution
- not improve the ability of interested parties to influence the operation of the administration
- inhibit the flexibility of deeds, as administrators and creditors would have to construct a proposal that is acceptable to the required 75% majority in value.

3.53 The Legal Committee does not consider that any matters should be required to be decided by special resolution.

Property owners as a separate class of creditors

3.54 The voting requirements in Part 5.3A do not provide for the court to order class meetings of creditors. The Legal Committee in its Discussion Paper considered whether the court should have this power.³³⁷ The rationale for separate class meetings, and requisite majorities at each meeting, is that a group of creditors with distinct and vested interests could otherwise use superior voting power to override the interests of other creditors.

3.55 The Legal Committee did not support the court having a general power to constitute classes of unsecured creditors for voting purposes,³³⁸ as:

- the criteria for determining classes are uncertain
- the interests of particular classes of creditors can be protected through the court's power to terminate a deed, which can be exercised, for instance, where the interests of particular creditors have been unfairly prejudiced³³⁹
- the considerable court time that may be spent in determining an application to constitute classes would be contrary to the aim of dealing expeditiously with a company's affairs.

3.56 Instead, the Legal Committee proposed in its Discussion Paper that the court should have a limited power to order that creditors who are also the owners of property used by the company in its business should be a class of creditors for the purpose of voting on a deed of company arrangement.³⁴⁰ Currently, Part 5.3A requires

³³⁵ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

³³⁶ Ernst & Young *Submission*.

³³⁷ At 88-89.

³³⁸ For instance, employees and related party creditors should not be constituted as separate classes of creditors.

³³⁹ s 445D(1)(f); Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 602; ALRC 45, vol 1, para 113.

³⁴⁰ Proposal 45.

either the consent of each owner or lessor of property (property owner) or an order of the court before that person can be bound by the deed.³⁴¹ In some cases, it may be extremely difficult, or even impossible, to obtain the consent of all property owners who constitute an identifiable class of creditors, for instance participants in forestry and viticultural syndicates under which the investors own the land and/or the produce. Likewise, it may be onerous to require a separate court application for each non-consenting property owner.

3.57 Under the Legal Committee's proposal, the court's role would be to constitute a class of these creditors. At the class meeting, a majority in number, and three quarters in value, of those present and voting should have the power to bind all those creditors to the deed. Also, to safeguard the rights of property owners, the Legal Committee considered that the court should only be able to constitute property owners as a class if that property is pooled in a single enterprise.

3.58 Some submissions supported the proposal that the court should have a power to constitute property owners as a class of creditors,³⁴² with one respondent³⁴³ making the following points.

- It should be made clear that property owners are only bound in respect of unpaid pre-administration amounts, not unpaid post-appointment debts.
Legal Committee response. The Legal Committee has elsewhere decided to retain the current law that the latest date for determining admissible claims is the date of the administrator's appointment, rather than the date on which creditors pass the resolution approving the proposed deed.³⁴⁴ Therefore, property owners will only be bound in respect of unpaid pre-administration amounts.
- The classification of property owners as a class of creditors should be relatively simple and should not need the court's involvement. If necessary, the administrator should be able to apply to the court for directions on who constitutes a class of property owners. The constitution of any class of property owners should be reviewable by the court on the application of an affected creditor.
Legal Committee response. The Legal Committee opposes the administrator having an independent power to classify a class of property owners. This power should only be exercisable by the court.

3.59 Others respondents disagreed with the Discussion Paper proposal,³⁴⁵ for the following reasons.

³⁴¹ ss 444D(3), 444F(4).

³⁴² Australian Credit Forum *Submission*, Ernst & Young *Submission*

³⁴³ Ernst & Young *Submission*.

³⁴⁴ s 444A(4)(i). Paras 5.1-5.4, post.

³⁴⁵ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Westpac *Submission*.

- Creditors should not be divided into separate classes, as this only complicates the voting procedures.³⁴⁶
Legal Committee response. The Legal Committee agrees that, in general, there should not be separate classes of creditors. However, it may be necessary to classify property owners separately, particularly where some of them cannot be located. Without this power, a voluntary administration may be unable to proceed.
- There should be only one type of voting mechanism.³⁴⁷
Legal Committee response. Owners of property are not currently bound by a deed unless they agree. The Legal Committee's proposal simply adds a procedure to bind them in appropriate circumstances.
- The proposal is unduly complex and may create additional problems, for instance how "pooled in a single enterprise" would be defined.³⁴⁸
Legal Committee response. The case law on prescribed interests would assist the courts and advisers in determining when assets are "pooled in a single enterprise".³⁴⁹
- The proposal could erode the position of some creditors, particularly those who may be secured, unless there are appropriate safeguards.³⁵⁰
Legal Committee response. The proposal does not apply to secured creditors. Prior court approval for the constitution of property owners as a class provides a safeguard for those creditors.

3.60 The Legal Committee maintains the view it adopted in its Discussion Paper.

Recommendation 20. The court should be able to order that creditors who are also the owners of property that is pooled in a single enterprise forming part of the company's business should be a class of creditors for the purpose of voting on a deed of company arrangement. The deed should bind all those creditors if a majority in number, and three quarters in value, of those present and voting vote to accept the deed.

³⁴⁶ Geoff McDonald *Submission*.

³⁴⁷ Geoff McDonald *Submission*.

³⁴⁸ VALRC *Submission*.

³⁴⁹ See HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (Butterworths loose leaf service) para [22.570].

³⁵⁰ Westpac *Submission*.

Chapter 4. Effect of appointment of administrator on creditors

This Chapter examines the impact of a voluntary administration on the rights of particular types of creditors over property owned or used by the company. It also discusses the rights of administrators to deal with that property.

Effect on transactions

4.1 Any transaction or dealing that affects property of a company and is entered into after the appointment of an administrator to the company is void unless done:

- by the administrator
- with the administrator's consent, or
- with the approval of the court.³⁵¹

4.2 There is an exception for payments made by an Australian bank from the company's account.³⁵² However, the payment must be made before the administrator notifies the bank of the administration³⁵³ or notice of the administration is published,³⁵⁴ whichever is the earlier. A payment may be voidable if made by the bank without written notice of the administration, but after publication of the notice. It has been suggested that, to avoid this result, administrators should be required to notify banks directly of their appointment.³⁵⁵

4.3 The Legal Committee in its Discussion Paper³⁵⁶ did not favour a specific requirement for administrators to notify banks of their appointment, as:

- banks can assess the financial position of their customers, for instance, by subscribing to the Alert service provide by the Commission
- the law should not afford different rights to individuals depending on the nature of their business.

4.4 However, two submissions from banks favoured a requirement for administrators to notify banks.³⁵⁷ They made the following points.

- It would not be onerous for those in possession of the primary information to be required to communicate it directly to bankers. An administrator should be able to identify the relevant banks and notify the appropriate branch within 3 business days, whereas a bank may need some time to identify whether the company concerned has any connection with it. By

³⁵¹ s 437D(1), (2).

³⁵² s 437D(3).

³⁵³ Under s 450A(3) or otherwise.

³⁵⁴ s 450A(1)(b).

³⁵⁵ J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,453.

³⁵⁶ At 13.

³⁵⁷ Australian Bankers' Association *Submission*, Westpac *Submission*.

that time, the bank may have increased its debts, for instance by paying cheques.

Legal Committee response. By contrast, one submission, in supporting the Legal Committee's view, pointed out that "administrators are not necessarily able to identify all of the company's bankers immediately".³⁵⁸

- The argument that there should be no distinction between different classes of individuals based on their business ignores the volume of banking transactions with general trade creditors.
- Banks must make immediate decisions, for instance, to pay or dishonour cheques within the business day.
- While banks can rely on official published sources such as the Commission's Alert service when available, that Alert service does not appear to be a means of notification recognised by the Corporations Law.
Legal Committee response. Lack of recognition by the Corporations Law does not detract from the effectiveness of the Commission's Alert service as a means of notification.
- A bank that does not hold a charge over the company's assets must rely solely on newspaper notices for notification. The likelihood of a branch manager missing a newspaper notice is quite high.
Legal Committee response. The cost of ensuring that a bank is aware of the appointment of an administrator should be borne by the bank itself, not by all creditors. One commentator has pointed out that, if a bank's actions in honouring a cheque drawn on the company's account are voidable, the bank can protect itself by having procedures to ensure that:
 - where the bank holds a charge on the whole or substantially the whole of the customer's property, written notices received under s 450A(3) are channelled to an appropriate person within the bank with responsibility for notifying the relevant bank branch as soon as possible, and
 - an appropriate person within the bank is responsible for ensuring that newspapers are checked every business day for notices of appointment of an administrator over any of the bank's corporate customers.³⁵⁹

4.5 The Legal Committee is not convinced that there should be special notice requirements for banks. The problem of honouring cheques arises in any insolvency.

4.6 One of the submissions suggested that transactions by banks should not be void if the court orders otherwise, as under s 468.³⁶⁰ The Corporations Law already gives the court this power.³⁶¹

³⁵⁸ Geoff McDonald *Submission*.

³⁵⁹ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 86.

³⁶⁰ Australian Bankers' Association *Submission*.

³⁶¹ s 437D(4).

Contractual terms altering rights on the appointment of an administrator

4.7 Contracts to which a company is a party can include provisions which enable the other party to take certain action merely because the company appoints an administrator. The Legal Committee in its Discussion Paper noted an argument that this possibility is contrary to the intention of Part 5.3A to impose a total restriction on the rights of persons who deal with a company under administration.³⁶² The Discussion Paper noted the Law Reform Commission recommendation that the legislation should, unless the court otherwise orders, render void against a liquidator or administrator a provision to the effect that, if a company commences to be wound up or becomes a company under administration:

- an agreement is to terminate or may be terminated
- the operation of an agreement is to be modified, or
- property to which the agreement relates may be repossessed by a person other than the company.³⁶³

4.8 There is a similar provision in the Bankruptcy Act.³⁶⁴

4.9 The Legal Committee also noted that the Corporations Law already allows an administrator to deal in the ordinary course of business with property that is subject to a floating charge that becomes fixed on the appointment of the administrator.³⁶⁵ However, the Legal Committee did not support adopting a wider provision of the type suggested by the Law Reform Commission, as it could place too great a restriction on the contractual rights of creditors.³⁶⁶

4.10 Most submissions on the Discussion Paper supported the Legal Committee's view.³⁶⁷

4.11 Some submissions supported a restriction on contractual provisions,³⁶⁸ for the following reasons.

- 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

³⁶² At 42-43.

³⁶³ ALRC 45, vol 2, s AT10. See also vol 1, paras 703-705.

³⁶⁴ Bankruptcy Act s 301.

³⁶⁵ ss 442B, 442C, Explanatory Memorandum to the Corporate Law Reform Bill 1992 para 553. It appears that the holder of a floating charge would ordinarily retain a charge over the proceeds of sale of the stock and so be in no worse position as a result of the sale, except that the chargee will have no control over the price the administrator obtains for the charged property: P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 140.

³⁶⁶ Proposal 17.

³⁶⁷ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, VALRC *Submission*, Westpac *Submission*.

³⁶⁸ Horwath *Submission*, Geoff McDonald *Submission*.

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.³⁶⁹

- The failure to restrict contractual provisions which would enable a party to take certain action merely because the company appoints an administrator totally defeats the purpose of the law. Recent amendments to the Bankruptcy Act have extended the restrictions on contractual rights that operate merely because of insolvency.³⁷⁰ The other contractual rights should be sufficient to protect the solvent party.³⁷¹

4.12 By contrast, one of the submissions that supported the Legal Committee's view made the following points.³⁷²

- 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 the administrator or a matter closely connected with the appointment.
- A bank would not be able to terminate a facility agreement. It could be forced to continue to provide the company with funding for which, in the absence of other amendments, the administrator would not be personally liable. This is because the funding does not constitute services rendered, goods bought or property hired, leased, used or occupied (the transactions for which an administrator is personally liable).³⁷³

4.13 These points reinforce the Legal Committee's view that contractual provisions should not be restricted.

Recommendation 21. There should be no additional restriction on contractual provisions which enable a party dealing with a company to take certain action merely because the company appoints an administrator.

Chargee's power to replace an administrator

4.14 Currently, a chargee over all or substantially all the property of a company can enforce the charge, including by appointing a receiver, within 10 business days of being notified of the appointment of an administrator.³⁷⁴ The Legal Committee in its Discussion Paper raised for discussion whether a chargee who does not appoint a receiver should instead be permitted to replace an administrator appointed by a company's board of directors with its own appointee.³⁷⁵ Creditors would still have the power to change the chargee's choice of administrator at the first meeting.

³⁶⁹ Horwath *Submission*.

³⁷⁰ Bankruptcy Act ss 302A, 302AB, 302B.

³⁷¹ Geoff McDonald *Submission*.

³⁷² Ernst & Young *Submission*.

³⁷³ s 443A.

³⁷⁴ s 441A, s 9 definition of "decision period". The chargee must be notified of the appointment as soon as practicable, and in any event before the end of the next business day after the appointment: s 450A(3).

³⁷⁵ At 12.

4.15 The advantage of the change is the incentive it could provide to a chargee to leave a company in administration, and replace the administrator with its own nominee, rather than put the company into receivership. However, the chargee would have no guarantee that creditors would not subsequently change the administrator appointed by the chargee. The result could be a costly succession of three administrators in a very short time. For these reasons, the Legal Committee did not favour the change. In support of this approach, one submission pointed out that the administration process is for the benefit of the company and all of its creditors, not for the benefit of chargeholders.³⁷⁶

Liens, pledges and reservation of title clauses

Current law

Chargees and owners or lessors of property

4.16 Once an administrator has been appointed to a company, chargees and owners or lessors of property used, leased or occupied by the company are prohibited from exercising their rights without the consent of the administrator or the leave of the court.³⁷⁷ Equally, however, the administrator is prohibited from disposing of property that is charged or is owned by someone else, unless:

- the chargee or owner consents
- the court grants leave, or
- the disposal is in the ordinary course of the company's business.³⁷⁸

4.17 This approach gives administrators flexibility in administering companies while protecting the rights of chargees and property owners or lessors. The Legal Committee supports this approach.

Liens and pledges

4.18 Secured creditors who have a lien or pledge over property of a company under administration can enforce their security by keeping possession of that property.³⁷⁹ They are not bound by the moratorium or other provisions of Part 5.3A that bind the holders of charges.

³⁷⁶ Geoff McDonald *Submission*. MD Chapple, "Voluntary Insolvency Administration: Some Reforms Part I" [1997] *Butterworths Corporation Law Bulletin* [91] also supported the Legal Committee's approach.

³⁷⁷ ss 440B, 440C.

³⁷⁸ s 442C.

³⁷⁹ *Osborne Computer Corporation Pty Ltd v Airroad Distribution Pty Ltd* (1995) 17 ACSR 614, 13 ACLC 1,129. A lien or a pledge is a possessory security that depends for its validity on the secured creditor retaining possession of the property. By contrast, a charge is an encumbrance on the property and does not depend on the chargee having physical possession. In *Osborne*, Rolfe J held that the administrator's right to control a company's property (s 437A(1)(a)) does not extend to permitting the administrator to destroy the contractual rights under a pledge. Also, the provision voiding transactions in company property on behalf of the company (unless the administrator consents or the court makes an order) (s 437D) does not extend to transactions carried out in enforcing a lien or pledge.

4.19 This differs from the Law Reform Commission approach. The Commission intended that all secured creditors (with only limited exceptions), including lienees and pledgees, should be subject to the moratorium on exercise of creditors' rights that comes into force when the administration begins.³⁸⁰ Also, the inability of the administrator to control property subject to liens or pledges could detract from the flexibility needed to conduct the company's affairs effectively.

Property subject to reservation of title clauses

4.20 A company under administration may be in possession of property that has been sold to it subject to a reservation of title clause.³⁸¹ Except with the leave of the court, an administrator is prohibited from selling this property after the reservation of title creditor has lawfully demanded its return. To do so would be outside the ordinary course of the company's business.³⁸²

4.21 This restriction is inconsistent with the underlying purpose of Part 5.3A (maximising the opportunity to preserve as much as possible of a company's business with minimum court involvement), for the following reasons.³⁸³

- A reservation of title creditor could simply serve notice demanding return of the property unless the administrator agrees to pay that creditor for the property and for all other debts owing to that creditor. That creditor, if paid by the administrator, would effectively receive a preference over all other unsecured creditors which could not be challenged in a subsequent liquidation.³⁸⁴
- The administrator cannot continue the company's business for the benefit of all creditors without obtaining the leave of the court to dispose of reservation of title property once the reservation of title creditor has

³⁸⁰ ALRC 45, vol 1, paras 56, 96.

³⁸¹ A reservation of title clause provides that title to goods does not pass until the purchaser has paid the vendor for those goods. These clauses effectively make vendors secured creditors in relation to the goods. Cohen J in *Osborne Computer Corporation Pty Ltd v Riddell* (1995) 17 ACSR 606 at 610-611, 13 ACLC 1,210 at 1,213-1,214 considered it unlikely that property subject to a reservation of title clause was intended to be included in this restriction. However, it is clear that the Law Reform Commission recommendations were intended to extend to "persons who claim title to property through 'retention of title' contract provisions": ALRC 45, vol 1, para 96. For further discussion of the effect of voluntary administrations on reservation of title clauses, see R Mansueto, "Retention of Title Claims in the Context of Voluntary Administration" (1996) 14 *Company and Securities Law Journal* 36, A Lo Surdo, "The Effect of Part 5.3A of the Corporations Law on Retention of Title Creditors" (1996) 4 *Insolvency Law Journal* 63, B Collier, "Uncertain Rights and Potential Liabilities: The Complex Position of Suppliers with Retention of Title Clauses and Administrators Under Part 5.3A of the Corporations Law" (1998) 9 *Journal of Banking and Finance Law and Practice* 42.

³⁸² *Osborne Computer Corporation Pty Ltd v Riddell* (1995) 17 ACSR 606, 13 ACLC 1,210. The administrator may only sell property in the possession of the company but owned by someone else in the ordinary course of business, with that person's consent or with the leave of the court: s 442C.

³⁸³ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 144.

³⁸⁴ s 451C.

demanded its return, even if the administrator has legitimate doubts about the validity of the reservation of title clause.

Legal Committee proposal on liens, pledges and reservation of title clauses

4.22 The Legal Committee in its Discussion Paper sought to balance the rights of lienees, pledgees and reservation of title creditors to retain the essence of their security against the requirements of efficient administration by proposing that:

- lienees and pledgees should be prohibited from exercising their rights without the consent of the administrator or the leave of the court
- administrators should be permitted to sell property subject to liens or pledges, as well as property that is subject to a reservation of title clause, provided that they hold the total sale proceeds for distribution to the holders of those possessory securities, subject to prior distribution to any person with a higher priority in law³⁸⁵
- however, where that property is also subject to a charge, the administrator may sell the property only if the prerequisites for selling charged property have been satisfied³⁸⁶
- lienees, pledgees and reservation of title creditors should have a right to seek a court order for possession of property if the administrator proposes to sell the property and there is a reasonable doubt about the administrator's willingness or ability to account for the invoice value of the property (for instance, lienees or pledgees might not receive full payment of their debts if other secured creditors have a higher priority over the sale proceeds).³⁸⁷

³⁸⁵ In *Osborne Computer Corporation Pty Ltd v Riddell* (1995) 17 ACSR 606, 13 ACLC 1,210, Cohen J gave leave to the administrator to sell goods subject to a reservation of title clause on condition that the administrator continue with arrangements under which the proceeds of sale of the goods were paid into a separate account. One commentator has described this condition as “a sensible compromise which protects the supplier’s legitimate claim in respect of the invoiced price of the goods without inhibiting the administrator in the disposal of the goods”: J O’Donovan, “Suppliers and Voluntary Administrators” (1996) 14 *Company and Securities Law Journal* 52.

³⁸⁶ s 442C.

³⁸⁷ Proposal 15.

Submissions on liens, pledges and reservation of title clauses

Comments on Discussion Paper proposal

4.23 Some submissions agreed with the Legal Committee's proposal in its entirety.³⁸⁸

4.24 One submission, while agreeing with restrictions on the ability of lienees and pledgees to exercise their rights, expressed the following reservations about the proposal.³⁸⁹

- The words "subject to prior distribution to any person with a higher priority *in law*" may not cover equitable interests under a floating charge. If that were so, the interests of lienees, pledgees and reservation of title creditors may be elevated above those of a registered chargee, whose charge would probably have crystallised.

Legal Committee response. It should be made clear that distributions to lienees, pledgees and reservation of title creditors are subject to prior equitable, as well as legal, interests.

- The requirement that charged property may only be sold if the prerequisites for selling charged property have been satisfied may reduce the usefulness of the proposal. To sell property subject to a fixed charge requires a release from that charge. That release usually requires the payment of the sale proceeds to the chargee.

Legal Committee response. This aspect of the Legal Committee's proposal is primarily concerned with how administrators may deal with property subject to liens or pledges. Administrators may only sell property that is also subject to a charge if the "prerequisites for selling charged property" are satisfied. Those prerequisites are sale in the ordinary course of business or with the written consent of the chargee or with the leave of the court.³⁹⁰ Administrators thus have ways to sell property subject to a charge, even where (as in the situation referred to in the submission) the chargeholder may be unwilling to provide a release (for instance, because some other person has a higher priority in law over the proceeds of that charge).

³⁸⁸ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*. B Collier, "Uncertain Rights and Potential Liabilities: The Complex Position of Suppliers with Retention of Title Clauses and Administrators Under Part 5.3A of the Corporations Law" (1998) 9 *Journal of Banking and Finance Law and Practice* 42 at 64 also supported the Legal Committee's approach.

³⁸⁹ Westpac *Submission*. This submission also said that, where there is a diminishing market, or hazardous or wasting assets may in fact be more likely to cause detriment than benefit, the administrator should be permitted to sell for the best available price, with the consent of the creditors, or with the approval of the court.

³⁹⁰ s 442C(2).

4.25 Other submissions, while agreeing with preventing lienees and pledgees from exercising their rights without the administrator's consent or the leave of the court, only agreed with an administrator being permitted to sell property subject to a lien, pledge or reservation of title clause if the following conditions are satisfied.

- The property is sold as part of the ordinary business of the company or as part of a sale of the business as a going concern to a third party.³⁹¹

Legal Committee response. The Legal Committee agrees with this condition. However, it notes that the core problem in relation to property subject to reservation of title clauses is that any sale of this property after the reservation of title creditor has lawfully demanded its return is outside the ordinary business of the company.³⁹² There thus needs to be a specific provision that any demand by the creditor to return property does not, of itself, take any subsequent sale outside the ordinary business of the company. Likewise, a sale of property subject to a lien or pledge should not be outside the ordinary business of a company merely because the lienee or pledgee has possession of that property. Also, an administrator should not be liable for conversion for any sale of property in accordance with the Legal Committee's proposals.³⁹³

- Any obligation to remit the sale proceeds to the relevant creditor should be limited to the net proceeds of sale after deducting the administrator's costs and expenses.³⁹⁴

Legal Committee response. The Legal Committee does not agree. It considers it undesirable to permit a sale of property subject to any form of security if the administrator cannot guarantee the payment in full of the relevant creditor's debt.³⁹⁵

³⁹¹ Law Council of Australia *Submission*, VALRC *Submission*.

³⁹² *Osborne Computer Corporation Pty Ltd v Riddell* (1995) 17 ACSR 606, 13 ACLC 1,210. The administrator may only sell property in the possession of the company but owned by someone else in the ordinary course of business, with that person's consent or with the leave of the court: s 442C.

³⁹³ This immunity from an action in conversion would overcome the problem raised in the Law Council of Australia *Submission* about a possible claim in conversion which might be brought by a lienee, pledgee or reservation of title creditor against an administrator. The liability of administrators for conversion under the current law is discussed in B Collier, "Uncertain Rights and Potential Liabilities: The Complex Position of Suppliers with Retention of Title Clauses and Administrators Under Part 5.3A of the Corporations Law" (1998) 9 *Journal of Banking and Finance Law and Practice* 42 at 62-64.

³⁹⁴ Law Council of Australia *Submission*. VALRC *Submission* also considered that a sale in the ordinary course of business should be permitted even if the sale proceeds are insufficient to pay the debt owing to those creditors (though in that event, the administrator should still be obliged to hold the invoice value of the goods for distribution if and when the reservation of title claim can be established).

³⁹⁵ Geoff McDonald *Submission*, in agreeing with Proposal 15 in the Discussion Paper, states that "the Administrator will have to receive at least the cost price of the goods so as to discharge the debt due to the owners of the goods".

- The administrator's right to sell property subject to liens, pledges or reservation of title clauses should be conditional on the sale proceeds being sufficient to pay the debt owing to those creditors.³⁹⁶

Legal Committee response. The Legal Committee agrees that the interests of lienees, pledgees and reservation of title creditors should be appropriately protected. However, rather than imposing this condition on any possible sale, a better approach might be to impose personal liability on administrators, as discussed below.

Full personal liability proposal

4.26 After receiving submissions on its Discussion Paper, the Legal Committee sought further views on an alternative proposal, namely that the administrator should be personally liable to lienees, pledgees or reservation of title creditors for all money secured by liens, pledges or reservation of title clauses over property that the administrator either sells or uses in the course of the administration. This suggestion would be consistent with the general approach in Part 5.3A of protecting creditors who deal with a company under administration by imposing personal liability on the administrator.³⁹⁷

4.27 Most submissions opposed this full personal liability proposal, for the following reasons.

- It may render the administrator personally liable for amounts in excess of the monetary value of the relevant property, and perhaps even in excess of the value of the company's property over which the administrator has a right of indemnity. This could occur where an "all moneys" reservation of title clause provides that title in the property does not pass to the company until all debts owed to the creditor have been paid in full.³⁹⁸
- It is difficult to see a situation where a reservation of title creditor would suffer damage from the administrator merely using the property.³⁹⁹
- Merely using an asset may not in itself produce any net cash in the administration, whereas the administrator will incur an onerous liability.⁴⁰⁰

Limited personal liability proposal

4.28 One submission favoured an administrator being personally liable for the sale or use of property subject to liens, pledges or reservation of title clauses, on the ground that it would thereby allow the administrator the unrestricted use of the property and

³⁹⁶ Australian Credit Forum *Submission*, Westpac *Submission* on Discussion Paper Issue 2. Others submissions disagreed with imposing this condition: The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, VALRC *Submission*.

³⁹⁷ Discussion Paper Proposal 21 (now Recommendation 39 of this Report), ALRC 45, vol 1, para 88.

³⁹⁸ Law Council *Submission*, John Wardlaw *Submission*.

³⁹⁹ Richard Brien & Co *Submission*.

⁴⁰⁰ Richard Brien & Co *Submission*.

its proceeds in the day to day business of the company.⁴⁰¹ However, the submission said that it should be ensured that personal liability is limited to the purchase price of the property disposed of by the administrator, not other money secured by “all moneys” clauses.

4.29 Other submissions supported the administrator being permitted to sell property subject to liens, pledges and reservation of title clauses only if the administrator personally guarantees, or is liable for, the invoice price of the property to the relevant secured creditor (at least in the case of reservation of title creditors).⁴⁰² This approach would benefit both the administrator and the secured creditor:

- the administrator would not be required to hold all the sale proceeds, but only the invoice price of the property, with the remainder of the proceeds being available for use in the voluntary administration
- a secured creditor would not face the possibility of receiving less than the invoice price of the property and becoming unsecured for the remainder. Administrators would either not sell the property for less than its invoice price or rely on their indemnity from the general funds of the company to cover any difference between the sale price and the invoice price. One respondent pointed out that the benefit for the general body of creditors would be the possibility of obtaining a higher price for other assets where they are sold together with the property subject to a possessory security or property subject to a reservation of title clause.⁴⁰³

Legal Committee view on liens, pledges and reservation of title clauses

4.30 While lienees and pledgees should generally be subject to the same rights and obligations as other secured creditors, the Legal Committee considers that the special nature of their security rights should be recognised. Liens and pledges depend on the relevant secured creditor retaining possession of the property over which they have security. The Legal Committee therefore considers that lienees and pledgees should be permitted to retain possession of their security property. However, they should not be entitled to exercise any rights under the lien or pledge to sell that property during the course of a voluntary administration.⁴⁰⁴

⁴⁰¹ David Kerr *Submission*. KPMG *Submission* also supported this personal liability of the administrator.

⁴⁰² Australian Credit Forum *Submission*, Law Council of Australia *Submission*, VALRC *Submission*, John Wardlaw *Submission*. Similarly, Richard Fisher *Submission* submitted that the administrator should have a personal liability to the security holder or the vendor for the value or price of the goods. Westpac *Submission* also considered that personal liability of the administrator should be the means of protecting the interests of lienees, pledgees and reservation of title creditors. Cf *Osborne Computer Corporation Pty Ltd v Riddell* (1995) 17 ACSR 606, 13 ACLC 1,210. P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 145, while supporting the Discussion Paper proposal generally, also considered that the administrator should only be required to hold for the benefit of reservation of title creditors so much of the total sale proceeds as represents the invoice price of the goods to the company.

⁴⁰³ Law Council *Submission*.

⁴⁰⁴ In general, a lien does not give the holder a right of sale. However, some contracts might provide that the holder have the power of sale in certain circumstances. In these cases, strictly

4.31 Nevertheless, administrators should have the right to sell property subject to liens and pledges, as well as property subject to reservation of title clauses, in the ordinary course of the company's business. Potential purchasers should have a statutory right of reasonable access to inspect any property held by lienees or pledgees.

4.32 In the case of property subject to liens and pledges, the administrator's right should be subject to an obligation to retain the amount secured by the lien or the pledge and by any other security over that property having a higher priority in law or equity than the lien or the pledge, for payment to the holders of those securities. If the administrator sells the property for a lower amount, the administrator should be personally liable for the shortfall.⁴⁰⁵

4.33 In the case of property subject to a reservation of title clause, the administrator's right should be subject to an obligation to retain the invoice price of the property and any amount due to a person with a higher priority over that property, for distribution to the reservation of title creditor and that other person, if any. If the administrator sells the property for a lower amount, the administrator should be personally liable for the shortfall.⁴⁰⁶

4.34 Where the property being sold is also subject to a charge, the administrator may sell the property only if the sale is in the ordinary course of business, with the written consent of the chargee or with the leave of the court.⁴⁰⁷

4.35 In all cases, purchasers should obtain clear title to the property being sold, including the right to possession.

4.36 Lienees, pledgees or reservation of title creditors should have a right to apply to the court if they consider that they will be prejudiced if the sale of the property were to proceed.⁴⁰⁸

4.37 Administrators should have a right to apply to the court for an order enabling them to sell property held by lienees or pledgees or subject to a reservation of title clause without incurring personal liability where that immunity from personal liability would be reasonable in all the circumstances. For instance, an administrator may want to sell property subject to a lien or pledge whose value is low compared with the total debt owed to the lienee or pledgee.

4.38 Administrators should also be permitted to agree to the relevant lienees, pledgees or reservation of title creditors themselves selling property and retaining an

speaking, the lien should be classified as a pledge: *Osborne Computer Corporation Pty Ltd v Airroad Distribution Pty Ltd* (1995) 17 ACSR 614 at 620, 13 ACLC 1,129 at 1,134-1,135.

⁴⁰⁵ The personal liability of the administrator for any outstanding amount deals with the issue raised by M Chapple, "Voluntary Insolvency Administration: Some Reforms Part II" [1997] *Butterworths Corporation Law Bulletin* [103] of whether the lienee, pledgee or reservation of title creditor should have the right to return of the property in consideration of reducing its claim by the intended sale price nominated by the administrator.

⁴⁰⁶ Refer to the comments in the previous footnote.

⁴⁰⁷ s 442C(2).

⁴⁰⁸ Law Council of Australia *Submission*.

amount to cover the relevant debt (and returning any surplus to the administrator). However, this power should not apply where another creditor has a higher priority. Where the administrator lawfully consents to the relevant lienholder, pledgee or reservation of title creditor selling the relevant property, the administrator should have no personal liability, even where the sale price is less than the debt.

Distress for rent and workers' liens

4.39 The moratorium under Part 5.3A may not extend to the exercise of the remedy of distress for rent (in South Australia and Tasmania) or to workers' liens (in South Australia and the Northern Territory).⁴⁰⁹

4.40 One submission suggested that the Corporations Law should be amended to ensure that the moratorium extends to distress for rent.⁴¹⁰ The Legal Committee agrees. It also considers that its proposals regarding liens should apply to workers' liens.

Exemptions

Bankers' liens

4.41 The Australian Bankers' Association (ABA) submitted that "bankers' liens" should be exempt from the Legal Committee's proposals concerning liens. In consequence, bankers would retain their rights to enforce their liens without the consent of the administrator or the leave of the court. The ABA argued, for instance, that a bankers' lien over unpresented cheques and bills, usually exercised by presenting the cheque or bill of exchange on its maturity, would be unworkable if the banker needed to obtain the prior leave of the court.

4.42 The Legal Committee agrees that bankers' liens should be exempted from the voluntary administration provisions, given that:

- these liens only apply to cash (or its equivalent, such as bills of exchange and negotiable instruments), which the administrator would in any case have to hold on trust for the lienholder
- the payments system would become less certain if bankers' liens were included in the moratorium.

⁴⁰⁹ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 108, 173, J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,464, 11,575, WC Robinson, "Statutory Moratorium on Proceedings Against a Company" (1996) 24 *Australian Business Law Review* 429 at 437, RL Comazzetto, "Distraint for rent: Voluntary Administrations and Liquidations" (1995) Vol 7 No 4 *Australian Insolvency Bulletin* 4. See *Molit (No 55) Pty Ltd v Lam Soon Australia Pty Ltd* (1996) 19 ACSR 160 at 166, 14 ACLC 366 at 371 (Branson J).

⁴¹⁰ Australian Institute of Credit Management *Submission*.

Collateral lodged with a clearing house

4.43 The Australian Stock Exchange (ASX) said that the proposal to permit administrators to sell property subject to a lien or pledge could be interpreted as applying to shares lodged as security with the Options Clearing House (OCH). If so, OCH would not continue to accept shares or money market instruments as collateral. Obligations may therefore need to be covered with cash or some other more costly form of security that cannot be subject to a claim by an administrator (for instance, a third party or bank guarantee). This may create inefficiencies and unnecessarily increase the costs of trading on ASX's derivatives markets.

4.44 The Legal Committee agrees that shares lodged as collateral with the OCH, or any other recognised clearing house, should be specifically exempted from the voluntary administration provisions.⁴¹¹

Lienees and pledgees right to possession only

Recommendation 22. Persons who hold property of a company under administration as security under a lien or pledge should be entitled to retain possession of that property. However, they should not be entitled to exercise any rights under the lien or pledge to sell that property during the course of a voluntary administration.

*Administrator's right of sale***Recommendation 23.**

- . Administrators should have a right to sell property subject to liens, pledges and reservation of title clauses, provided that the property is sold as part of the ordinary business of the company or as part of a sale of the business as a going concern to a third party. For the purpose of determining "the ordinary business of a company", any demand by a reservation of title creditor to return property should not, of itself, take any subsequent sale outside the ordinary business of the company. Likewise, a sale of property subject to a lien or pledge should not be outside the ordinary business of a company merely because the lienee or pledgee has possession of that property.
- . Lienees, pledgees or reservation of title creditors should have a right to apply to the court if they consider that they will be prejudiced if the sale of the property were to proceed.
- . Where that property is also subject to a charge, the administrator may sell the property only if the sale is in the ordinary course of business, with the written consent of the chargee or with the leave of the court.
- . Potential purchasers should have a statutory right of reasonable access to inspect any property held by lienees or pledgees.

⁴¹¹ This would be consistent with the recommendations in the CASAC Netting Sub-Committee Final Report *Netting in Financial Markets Transactions* (June 1997).

- The purchaser should obtain clear title to the property being sold, including the right to possession.
- Administrators who exercise these rights of sale should have an immunity from any action in conversion.
- In the case of property subject to liens and pledges, the administrator's right should be subject to an obligation to retain the amount secured by the lien or pledge and by any other security over the property having a higher priority in law or equity than the lien or pledge, for payment to the holders of those securities. If the administrator sells the property for a lower amount, the administrator should be personally liable for the shortfall.
- In the case of property subject to a reservation of title clause, the administrator's right should be subject to an obligation to retain the invoice price of the property and any amount due to a person with a higher priority over that property, for distribution to the reservation of title creditor and that other person, if any. If the administrator sells the property for a lower amount, the administrator should be personally liable for the shortfall.
- Administrators should have a right to apply to the court for an order enabling them to sell property held by lienees or pledgees or subject to a reservation of title clause without incurring personal liability where that immunity from liability would be reasonable in all the circumstances.

Creditor's right of sale

Recommendation 24.

- Except where another creditor has a higher priority, the administrator may agree to a lienee, pledgee or reservation of title creditor selling the property and retaining an amount to cover the relevant debt (and returning any surplus to the administrator). Where this occurs, the administrator would have no personal liability to the selling creditor, even where the sale price is less than the debt.
- Creditors should not be able to exercise rights of sale under distress for rent, or workers' liens, during an administration.

Exemptions

Recommendation 25. There should be an exemption from the moratorium under Part 5.3A for:

- . bankers' liens
- . shares lodged as collateral with any recognised clearing house.

Enforcement action by chargees**Current law**

4.45 Part 5.3A contains two exceptions from the moratorium provisions for chargees:

- . the holder of a charge over the whole, or substantially the whole, of the property of a company may enforce, or continue to enforce, the charge, notwithstanding the appointment of an administrator, provided the enforcement action is taken against all the charged property⁴¹² and begins before the end of the tenth business day after the chargee receives notice of the administration⁴¹³
- . in other cases, a chargee may continue to enforce a charge over particular property if the enforcement begins before the appointment of the administrator.⁴¹⁴

4.46 The court has power, if satisfied that a chargee's interests will be protected, to restrain action taken by a chargee in the second situation.⁴¹⁵ However, the court has no power to stop enforcement action begun by a chargee in the first situation.

4.47 The Legal Committee has considered three concerns with these provisions, as discussed below.

Inconsistent treatment of chargees

4.48 An injunction can be sought against a chargee who is entitled to take action against all or substantially all the property of a company, but takes enforcement action only against particular property. However, an injunction cannot be sought if the same chargee takes enforcement action against all the charged property.

4.49 The Legal Committee in its Discussion Paper did not consider that the law in this regard should be changed.⁴¹⁶ A creditor who can appoint a receiver over all a company's property can "achieve the same kind of orderly administration of the company's affairs that will be made possible by the appointment of an

⁴¹² The chargee can only avoid the possibility of a s 441D injunction by enforcing the charge "in relation to all property of the company subject to the charge": s 441A(1)(b).

⁴¹³ s 441A, s 9 definition of "decision period".

⁴¹⁴ s 441B.

⁴¹⁵ s 441D.

⁴¹⁶ At 47.

administrator”.⁴¹⁷ The purpose of the present limited injunction power is to avoid the fragmentation of the administration of a company’s affairs that could occur if a chargee takes enforcement action only against particular property of the company.

4.50 No submissions took a contrary view.

No power to grant a preventative injunction

4.51 The court’s injunction powers cover actual, but not foreshadowed, enforcement action by a chargee over particular property.⁴¹⁸ A power to grant an injunction against a threatened enforcement action over particular property (a *quia timet* injunction) may be necessary, for instance, where a chargee who has assumed control of that property (and thus come within the exemption for chargees⁴¹⁹) proposes to make arrangements for sale of the property.⁴²⁰ The Legal Committee in its Discussion Paper proposed that an administrator should be able to seek a preventative injunction in these circumstances.⁴²¹

4.52 Some submissions supported this proposal.⁴²² One of these submissions pointed out that the proposal merely overcomes an anomaly.⁴²³

4.53 Other respondents disagreed with the proposal,⁴²⁴ for the following reasons.

- It further erodes the rights of secured creditors by preventing a chargee who has assumed control of particular property (and thus come within the exemption for chargees⁴²⁵) from carrying out intended realisation arrangements.⁴²⁶
Legal Committee response. The current provision already gives the court a power to stop actions that a secured creditor has taken to realise particular property. The secured creditor would be no worse off, and may even avoid unnecessary costs, if the court prohibited the action before it took place.
- The court already has sufficient powers to grant relief against threatened enforcement action.⁴²⁷

⁴¹⁷ Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 536. See also ALRC 45, vol 1, para 67.

⁴¹⁸ s 441D(1)(a).

⁴¹⁹ s 441B(1)(a).

⁴²⁰ s 441B(1)(b), (c), (d).

⁴²¹ Proposal 19.

⁴²² Australian Credit Forum *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*.

⁴²³ Geoff McDonald *Submission*.

⁴²⁴ Australian Bankers’ Association *Submission*, Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*, Westpac *Submission*.

⁴²⁵ s 441B(1)(a).

⁴²⁶ Australian Bankers’ Association *Submission*, Westpac *Submission*.

⁴²⁷ Australian Bankers’ Association *Submission*, Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*. Similarly, the VALRC *Submission*, while

Legal Committee response. It is preferable for the court to have a specific power in this regard than to rely on its general powers.

- It would allow the administrator to expend assets of the company obtaining court orders against chargees who may be issuing idle threats.⁴²⁸

4.54 The Legal Committee maintains its view that the court's injunction power should extend to threatened enforcement actions.

Recommendation 26. The court's power to grant an injunction against enforcement action by a chargee over particular property, on application by an administrator, should be extended to cover injunctions against threatened enforcement actions.

Court enforcement procedures

4.55 A chargeholder over all or substantially all the property of a company can continue enforcing its charge if it commenced enforcement before or during the 10 day decision period that follows the commencement of the administration (the substantial chargeholder's exception).⁴²⁹

4.56 Similarly, other chargeholders can continue enforcing their charges over particular property of the company if, before the beginning of the administration, they have:

- entered into possession, or assumed control, of the property
- entered into an agreement to sell the property
- made arrangements for the property to be offered for sale by public auction
- publicly invited tenders for the purchase of the property, or
- exercised any other power in relation to the property (the other chargeholders' exception).⁴³⁰

4.57 These provisions specifically override the prohibition on enforcement of a charge during a company's administration.⁴³¹ However, a recent case⁴³² has raised the possibility that chargeholders may not be able to enforce their charges during that period through court proceedings, given the separate specific prohibitions on court enforcement procedures.⁴³³

4.58 The apparent policy underlying the provisions that override the prohibition on enforcement of a charge during a company's administration is to permit chargeholders to continue their enforcement action after the commencement of an administration, notwithstanding the moratorium. It therefore seems appropriate to amend the relevant

supporting the general thrust of the Legal Committee's proposal, considered that it may be preferable to let the court rely on its powers under s 447A.

⁴²⁸ Westpac *Submission*.

⁴²⁹ s 441A, s 9 definition of "decision period".

⁴³⁰ s 441B.

⁴³¹ s 440B.

⁴³² *Albert v Namba Pty Ltd* (1997) 24 ACSR 577 at 579.

⁴³³ ss 440F, 440G.

provisions to expressly permit chargeholders to enforce their rights through the courts during the administration period in the stipulated circumstances.

Recommendation 27. Chargeholders who are permitted by the Corporations Law to enforce their charges should be able to do so during the administration period through court enforcement, as well as extra-curial, action.

Right of property owners to repossess their property

4.59 During the administration of a company, owners of property that is used or occupied by, or in the possession of, the company cannot generally take possession of the property without the administrator's written consent or the leave of the Court.⁴³⁴ However, a person who has:

- (i) entered into possession of the property, or
- (ii) exercised "any other power" in relation to the property

before the beginning of the administration may take possession.⁴³⁵

4.60 The Legal Committee in its Discussion Paper considered that the reference to the exercise of "any other power" in situation (ii) was unclear.⁴³⁶ It must be something less than taking physical possession, which is already covered by situation (i). It may extend to any type of recovery action aimed at taking possession of the property, for instance, the service of a notice of default.⁴³⁷ The Discussion Paper proposed that the restrictions on the rights of property owners should apply unless they have already taken possession of their property before the administration begins, so that the legislation would no longer exempt property owners from the moratorium provisions in situation (ii).⁴³⁸

4.61 Many submissions supported this proposal.⁴³⁹

4.62 Other submissions opposed the proposal,⁴⁴⁰ for the following reasons.

⁴³⁴ s 440C.

⁴³⁵ s 441F.

⁴³⁶ At 48.

⁴³⁷ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 135 considers that the phrase "exercised any other power" would probably not extend to a notice of default under a lease or hire purchase agreement or a notice of breach of the terms and conditions of supply of goods supplied on reservation of title terms. See also the discussion in B Collier, "Uncertain Rights and Potential Liabilities: The Complex Position of Suppliers with Retention of Title Clauses and Administrators Under Part 5.3A of the Corporations Law" (1998) 9 *Journal of Banking and Finance Law and Practice* 42 at 46-48.

⁴³⁸ Proposal 20.

⁴³⁹ Australian Credit Forum *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*. Westpac *Submission* only supported the proposal where the right enforced by the owner would be fundamentally adverse to the company's capacity to trade. This would not be the case, for instance, for motor vehicles leased for the personal use of directors, and similar "fringe benefit" types of property.

⁴⁴⁰ Australian Bankers' Association *Submission*, Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

- . It could cause serious practical problems, for instance, where a property owner has sold the property, but the contract has yet to settle, or where a receiver has been appointed.⁴⁴¹
- . There should be no relevant distinction between the different ways in which a secured creditor may choose to enforce its security.

4.63 One submission pointed out that the same phrase could also be deleted from the provision relating to chargeholders.⁴⁴²

4.64 The Legal Committee has reconsidered this matter, as case law since publication of the Discussion Paper has clarified what may be covered by the exercise of “any other power”. It could refer, for instance, to the execution of a warrant for possession.⁴⁴³ It may be justifiable to permit enforcement action to continue where this type of power has been exercised before the commencement of an administration. The Committee therefore considers that the reference in the Corporations Law to “any other power” should remain, with the courts being left to develop the law in this area.

⁴⁴¹ Australian Bankers’ Association *Submission*.

⁴⁴² s 441B. Richard Fisher *Submission*.

⁴⁴³ *Albert v Namba Pty Ltd* (1997) 24 ACSR 577.

Chapter 5. Deeds of company arrangement

This Chapter deals with the creditors that should be covered by a deed of company arrangement, the contents of a deed, public disclosure that the company has entered into a deed, the effect of deeds on guarantees and the circumstances in which a deed may be terminated.

Date for admission of creditors' claims under a deed

Date for admissible claims

5.1 Currently, the latest date for determining admissible claims is the date of the administrator's appointment.⁴⁴⁴ One commentator has pointed out that a claim by a reservation of title creditor may not arise until after that date. If so, that creditor would not be entitled to vote on the deed of company arrangement. Conversely, that creditor would not be bound by the deed and could take action to recover the debt, possibly jeopardising the success of the deed.⁴⁴⁵

5.2 The Legal Committee in its Discussion Paper proposed that the date for admissible claims should be extended until the date on which creditors pass the resolution approving the proposed deed.⁴⁴⁶ However, it invited submissions on any problems that may arise as a result of the consequent possible increase in the number of creditors bound by the deed.⁴⁴⁷

5.3 Some submissions supported extending the date for admissible claims to the date of the creditors' resolution.⁴⁴⁸ Many opposed it,⁴⁴⁹ for the following reasons.

- It may introduce uncertainty regarding the level and number of creditors bound by the deed.⁴⁵⁰
- It may prevent the administrator from being able to properly inform the creditors about their likely return from the administration.⁴⁵¹
- Voting at meetings of creditors in a voluntary administration should be restricted to creditors who have debts arising from pre-administration agreements or transactions.⁴⁵²
- The voluntary administration provisions have been deliberately structured to prevent a deed of company arrangement from extinguishing,

⁴⁴⁴ s 444A(4)(i).

⁴⁴⁵ Memorandum prepared by Professor J O'Donovan for the Voluntary Administration Sub-Committee of the Law Council.

⁴⁴⁶ Proposal 16.

⁴⁴⁷ s 444D(1).

⁴⁴⁸ Australian Credit Forum *Submission*, Westpac *Submission*.

⁴⁴⁹ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

⁴⁵⁰ Australian Institute of Credit Management *Submission*.

⁴⁵¹ Australian Institute of Credit Management *Submission*.

⁴⁵² Horwath *Submission*.

compromising or otherwise dealing with debts or claims incurred during the administration period. This is a useful disincentive for administrators continuing to trade otherwise non-viable businesses for an extended period (given the priority rights of these debts or claims and the personal liability of the administrator for them), to the ultimate detriment of pre-administration creditors.⁴⁵³

- The premise on which the proposal is founded (that the reservation of title creditor's claim may not arise until after the date of the administrator's appointment) appears to be flawed. A reservation of title creditor's claim may crystallise following a decision on the claim by the administrator, but that confirms a position that existed at the commencement of the administration.⁴⁵⁴
- The proposal could blur the distinction between the three classes of creditors' claims in an administration (pre-administration, during administration and post-administration).⁴⁵⁵
- The members of the class which is to be bound by a deed should be known no later than the time at which the notice convening the meeting is despatched, as for schemes of arrangement. All persons who are to be bound by a deed should have an opportunity to attend and participate in the meeting at which it is to be considered.⁴⁵⁶

5.4 The Legal Committee considers that the arguments against extending the current date for admissible claims outweigh any possible problems with that date.

Date for determining the amount of debt

5.5 The Discussion Paper also proposed that the legislation should stipulate that the amount of debt for which a creditor can vote should be limited to the amount outstanding when the vote is taken.⁴⁵⁷ For instance, where a guarantor has paid part of the company's debt by that date, the creditor should only be able to vote for the part that remains unpaid.

5.6 Some submissions agreed with this proposal.⁴⁵⁸ However, many submissions opposed the proposal,⁴⁵⁹ for the following reasons.

- A specific legislative provision is unnecessary, as the existing law in this area is sufficiently clear.⁴⁶⁰
- The law on the voting rights of creditors is not peculiar to voluntary administrations. Under the current law, creditors can presumably only vote

⁴⁵³ Law Council of Australia *Submission*. A similar point is made by Robert MH Cole & Co *Submission*.

⁴⁵⁴ VALRC *Submission*.

⁴⁵⁵ VALRC *Submission*.

⁴⁵⁶ Richard Fisher *Submission*.

⁴⁵⁷ Proposal 16.

⁴⁵⁸ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

⁴⁵⁹ Richard Fisher *Submission*, Horwath *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*.

⁴⁶⁰ Horwath *Submission*.

as creditors for the amount which they are owed as creditors at the time the vote is taken.⁴⁶¹

5.7 One submission also raised a concern about the possible effect that the proposed change could have in relation to amounts paid to a creditor by third parties. This could require major reform of the law of guarantees and subrogation and the rule against double proofs.⁴⁶²

5.8 Taking into account the points raised by respondents, the Legal Committee no longer favours the proposal to stipulate the date for determining the amount of debt.

Contingent creditors

5.9 A deed of company arrangement binds all creditors of the company in relation to claims arising on or before the day specified in the deed.⁴⁶³ The Legal Committee in its Discussion Paper considered whether the voluntary administration provisions should be brought into line with those relating to debts provable in a winding up, by stating expressly that the reference to creditors includes contingent creditors.⁴⁶⁴

5.10 The courts have held in a number of cases that the word ‘creditors’, in the context of a voluntary administration, includes contingent creditors.⁴⁶⁵ These creditors are therefore bound by a deed of company arrangement. The Legal Committee therefore did not see any current need for a legislative amendment.

5.11 One respondent to the Discussion Paper submitted that Part 5.3A should be amended to state expressly that claims which would have been admissible to proof in a liquidation of the company had it been wound up on the day the administrator was appointed will be bound by a deed of company arrangement, except to the extent to which the deed otherwise provides.⁴⁶⁶ He considered that the case law on this area

⁴⁶¹ Geoff McDonald *Submission*. VALRC *Submission* also regarded the current law as self-evident.

⁴⁶² Ernst & Young *Submission*.

⁴⁶³ s 444D(1).

⁴⁶⁴ At 65-66. Section 553 covers debts provable in a winding up.

⁴⁶⁵ *Brash Holdings Ltd v Katile Pty Ltd* (1994) 13 ACSR 464, 12 ACLC 472, *Petrochemical Industries Ltd (in liq) v Dempster Nominees Pty Ltd (admr apptd)* (1995) 15 ACSR 468, *Green v Giljohann* (1995) 17 ACSR 518, *Zambena Pty Ltd v Capitol Laundry Pty Ltd* (1996) 14 ACLC 241, *Molit (No 55) Pty Ltd v Lam Soon Australia Pty Ltd* (1996) 19 ACSR 160, 14 ACLC 366, *Lam Soon Australia Pty Ltd (admin apptd) v Molit (No 55) Pty Ltd* (1996) 22 ACSR 169, 14 ACLC 1,737, *Employers' Mutual Indemnity (Workers' Compensation) Ltd v JST Transport Services Pty Ltd* (1997) 23 ACSR 197, 15 ACLC 314. The decision in *Daydream Island International Resort Pty Ltd v Cushway Blackford & Associates Pty Ltd* (1994) 15 ACSR 443, 13 ACLC 82 adopted a contrary view. In that case, Shepherdson J considered that the court in *Brash Holdings* left open the possibility that “creditors” for the purposes of s 444D could be read more restrictively than in other sections of Pt 5.3A, if there was a good reason. This approach enabled His Honour to conclude that on the facts before him, s 444D(1) required a contingent claim to arise before the date specified in the deed as the cut-off date. This decision appears to be inconsistent with *Brash Holdings*: P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 79. The position of contingent creditors and the *Lam Soon* decision are discussed in J O'Donovan, “Lessors and deeds of company arrangement” (1998) 6 *Insolvency Law Journal* 15.

⁴⁶⁶ Richard Fisher *Submission*.

may not necessarily be followed in all jurisdictions, as there is a history of intermediate courts not following the decisions of courts of coordinate jurisdiction.

5.12 By contrast, other respondents supported the Legal Committee's suggestion that there should be no legislative amendment to the definition of creditors, as:

- this is a difficult area best left to the common law, which has given a wide meaning to the definition of creditors
- this area is not peculiar to voluntary administrations.⁴⁶⁷

5.13 The Legal Committee agrees that legislation to clarify the position of contingent creditors is inappropriate. The matter should continue to be left to the courts.

Secured creditors and property owners

5.14 Secured creditors and owners or lessors of property are not bound by a deed in relation to their security or property unless they agree.⁴⁶⁸ However, the court has the power to order that these persons be bound by a deed, notwithstanding that they have not agreed to be bound:

- where enforcement of their rights would materially adversely affect the arrangement, and
- provided their interests are adequately protected.⁴⁶⁹

5.15 This power applies where "it is proposed that a company execute a deed of company arrangement".⁴⁷⁰ The Legal Committee in its Discussion Paper noted that, on one interpretation, it is "proposed" that a company arrangement be accepted by creditors and executed by the company when the administrator first forms the view that it would be in the creditors' interests to enter into a deed of company arrangement (the earlier time).⁴⁷¹ However, logic and the fact that the provision appears in the Division dealing with the execution and effect of deeds of company arrangement⁴⁷² suggest that the section should only apply once creditors have formally resolved that a

⁴⁶⁷ Geoff McDonald *Submission*, Australian Bankers' Association *Submission*.

⁴⁶⁸ s 444D(2), (3).

⁴⁶⁹ ss 444D(2)(b), (3)(b), 444F.

⁴⁷⁰ s 444F(1)(a).

⁴⁷¹ s 439A(4)(b)(i). See Discussion Paper at 66. P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 181 considers that an administrator "could be said to be 'proposing' to have the company execute a deed of company arrangement as and from the time the administrator sends out the notice of the meeting to consider the company's future containing a basic proposal for the company to execute a deed of company arrangement". J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,556 states that a deed of company arrangement "might be 'proposed' in the relevant sense before the details of the arrangement are considered and approved by the creditors. It may well be sufficient for the basic elements of a company arrangement to be formulated." See also R Mansueto, "Retention of Title Claims in the Context of Voluntary Administration" (1996) 14 *Company and Securities Law Journal* 36 at 46.

⁴⁷² Division 10.

deed of company arrangement be executed (the later time). The Legal Committee proposed that the provision should specifically refer to the later time.⁴⁷³

5.16 Submissions generally supported this proposal.⁴⁷⁴

5.17 One respondent, opposing the proposal, considered that it would widen the courts' discretion over when it can exercise such powers.⁴⁷⁵ However, the proposal is merely intended to ensure that the court can make an order binding secured creditors only from the later time.

Recommendation 28. The court power to bind secured creditors or owners or lessors of real or personal property to a deed of company arrangement should only be exercisable after the creditors have resolved that a deed of company arrangement be executed.

The prescribed provisions

5.18 A deed of company arrangement is taken to include prescribed provisions, as set out in the Corporations Regulations, except so far as the deed provides otherwise.⁴⁷⁶

Making claims

5.19 The prescribed provisions apply to deeds of company arrangement certain Corporations Law provisions dealing with proof and ranking of claims in a winding up.⁴⁷⁷ These claim provisions cover:

- admission to proof of debts and claims⁴⁷⁸
- computation of debts and claims⁴⁷⁹
- matters relating to secured creditors⁴⁸⁰
- interest on debts and claims from the relevant date to the date of payment, debt subordination and the power of the court to make orders in favour of certain creditors.⁴⁸¹

5.20 One prescribed provision⁴⁸² states that the references to the liquidator are to be read as references to the deed administrator, but:

⁴⁷³ Proposal 29.

⁴⁷⁴ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

⁴⁷⁵ Ernst & Young *Submission*.

⁴⁷⁶ s 444A(5). The prescribed provisions are set out in Corp Reg 5.3A.06, Schedule 8A. The Law Reform Commission recommended these standard provisions: ALRC 45, vol 1, para 116.

⁴⁷⁷ Corp Reg 5.3A.06, Schedule 8A, cl 8.

⁴⁷⁸ Part 5.6, Division 6, Subdivision A (ss 553-553E).

⁴⁷⁹ Part 5.6, Division 6, Subdivision B (ss 554-554C).

⁴⁸⁰ Part 5.6, Division 6, Subdivision C (ss 554D-554J).

⁴⁸¹ Part 5.6, Division 6, Subdivision E (ss 563B-564).

⁴⁸² Corp Reg 5.3A.06, Schedule 8A, cl 8.

- does not state that the winding up provisions are to apply “with such modifications as are necessary”, or
- does not otherwise adapt the winding up provisions for deeds of company arrangement (for instance, by specifying a date to be the equivalent of the “relevant date” in a winding up⁴⁸³).⁴⁸⁴

5.21 The Legal Committee proposed the following amendments to this prescribed provision:⁴⁸⁵

- add the words “with such modifications as may be necessary”
- state that a reference to “the relevant date” means a reference to the commencement date of the deed
- refer to the regulations which deal with proof of debt procedures in a liquidation.⁴⁸⁶

5.22 Submissions generally supported this proposal.⁴⁸⁷

5.23 However, two submissions disagreed with the proposal that the reference to “the relevant date” should be read as a reference to the commencement date of the deed.⁴⁸⁸ One of these respondents said that the date should be the date of appointment of the administrator or such other date as specified in the deed.⁴⁸⁹ The other respondent said that the reference to the ‘relevant date’ should be construed as a reference to the date prior to which, according to the deed, claims must have arisen to be admissible.⁴⁹⁰

5.24 The Legal Committee, elsewhere in this Report, takes the view that the date for admissible claims should be the date of the administrator’s appointment, not the date on which creditors pass the resolution approving the proposed deed.⁴⁹¹ Consequently, the reference to “the relevant date” should be a reference to the date of the administrator’s appointment.

Recommendation 29. The prescribed provision dealing with making claims should be amended by:

⁴⁸³ The “relevant date”, in relation to a winding up, means the day on which the winding up is taken because of Division 1A of Part 5.6 to have begun: s 9 definition of “relevant date”.

⁴⁸⁴ Thus, GJ Hamilton, “Deeds of Company Arrangement: The Prescribed Provisions” (1995) 3 *Insolvency Law Journal* 67 at 83 argues that many of the provisions in Subdivisions A, B, C and E of Part 5.6 Division 6 do not apply to a deed of company arrangement, as they do not refer to the liquidator (for instance, s 553(1), which relates to the types of debts and claims that are admissible to proof and s 553C, which relates to mutual credits and set-offs).

⁴⁸⁵ Proposal 25. The Committee adopted the suggestion of GJ Hamilton, “Deeds of Company Arrangement: The Prescribed Provisions” (1995) 3 *Insolvency Law Journal* 67 at 82-83.

⁴⁸⁶ Corp Regs 5.6.39-5.6.57.

⁴⁸⁷ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*, Westpac *Submission*.

⁴⁸⁸ Ernst & Young *Submission*, Law Council of Australia *Submission*.

⁴⁸⁹ Ernst & Young *Submission*. The submission pointed out that this would require an amendment to s 444A(4)(i).

⁴⁹⁰ Law Council of Australia *Submission*.

⁴⁹¹ paras 5.1-5.4, *supra*.

- adding the words “with such modifications as may be necessary”
- stating that a reference to “the relevant date” means a reference to the date of the administrator’s appointment
- referring to the regulations which deal with proof of debt procedures in a liquidation.

Priorities

5.25 The insolvency priority rules relate to:

- equal ranking of debts⁴⁹²
- priority payments,⁴⁹³ including a priority for a person who advances money to a company to pay wages⁴⁹⁴
- application of proceeds of contracts of insurance and reinsurance⁴⁹⁵
- postponement of a seller’s claim under a buy-back agreement⁴⁹⁶
- postponement of members’ claims.⁴⁹⁷

5.26 The prescribed provisions only adopt the priority payment rules.⁴⁹⁸ However, the other priority rules⁴⁹⁹ may be useful in deeds of company arrangement (for instance, the provision giving a person who advances money to a company to pay wages the same priority as the employees would have had⁵⁰⁰).

5.27 The Legal Committee in its Discussion Paper proposed that the prescribed provision dealing with priority payments under a deed of company arrangement should incorporate all the priority provisions, not just s 556.⁵⁰¹ In consequence, those priority provisions would be incorporated in any deed of company arrangement, unless specifically excluded by the particular deed.

5.28 Most submissions supported this proposal.⁵⁰² However, some respondents queried the need for automatic application of all priority provisions to deeds of company arrangement.⁵⁰³ They suggested that provisions relating to s 556 could be applied to all deeds of company arrangement, but it may be more appropriate to include other priority provisions under the terms of particular deeds when, and if, desirable.

⁴⁹² ss 555, 559.

⁴⁹³ s 556. Other provisions that relate to the priority payment to employees are ss 558, 561 (priority of employees’ claims over a floating charge) and 563 (injury compensation).

⁴⁹⁴ s 560.

⁴⁹⁵ ss 562, 562A.

⁴⁹⁶ s 563AA.

⁴⁹⁷ s 563A.

⁴⁹⁸ Corp Reg 5.3A.06, Schedule 8A, cl 4 adopts s 556.

⁴⁹⁹ ss 555, 558-563A.

⁵⁰⁰ s 560.

⁵⁰¹ Proposal 26.

⁵⁰² Australian Credit Forum *Submission*, Ernst & Young *Submission*, Horwath *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

⁵⁰³ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

5.29 Some submissions disagreed with the proposal, on the ground that the prescribed provisions are not mandatory, but merely a convenient set of clauses which can be adapted to particular circumstances.⁵⁰⁴

5.30 On balance, the Legal Committee considers it preferable for all the priority provisions to be included in the prescribed provisions. An administrator could exclude these provisions from a particular deed of company arrangement if they were inappropriate.

Recommendation 30. The prescribed provision dealing with priority payments under a deed of company arrangement should incorporate all the priority provisions, not just s 556.

Meetings

5.31 There is an apparent duplication of the provisions governing meetings under deeds of company arrangement. There is a prescribed provision dealing expressly with this matter.⁵⁰⁵ However, the general regulations that apply to meetings of creditors in insolvency administrations⁵⁰⁶ also apply to meetings of creditors under a deed of company arrangement.⁵⁰⁷ Given this, the prescribed provision is not necessary.⁵⁰⁸ The Legal Committee in its Discussion Paper proposed that the provision be deleted.⁵⁰⁹

5.32 Most submissions supported this proposal.⁵¹⁰

5.33 Some submissions disagreed with the proposal, on the ground that the prescribed provisions are not mandatory, but merely a convenient set of clauses which can be adapted to particular circumstances.⁵¹¹ However, the Legal Committee considers that the prescribed provisions should not contain provisions that duplicate requirements found elsewhere in the Corporations Law.

Recommendation 31. The prescribed provision dealing with meetings should be deleted.

Committee of inspection

⁵⁰⁴ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

⁵⁰⁵ Corp Reg 5.3A.06, Schedule 8A, cl 9.

⁵⁰⁶ Corp Regs 5.6.12-5.6.36A.

⁵⁰⁷ Corp Reg 5.6.11(2)(aa).

⁵⁰⁸ GJ Hamilton, "Deeds of Company Arrangement: The Prescribed Provisions" (1995) 3 *Insolvency Law Journal* 67 at 83-84, P Lynch, "Drafting a Deed of Company Arrangement" (1995) 3 *Insolvency Law Journal* 115 at 121.

⁵⁰⁹ Proposal 27.

⁵¹⁰ Australian Credit Forum *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, VALRC *Submission*, Westpac *Submission*. Ernst & Young *Submission* considered that meeting procedures should not be open to variation. Creditors could find their decision-making inhibited if meeting procedures and requirements were allowed to be amended.

⁵¹¹ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

5.34 The prescribed provisions say that there must be a committee of inspection.⁵¹² The Legal Committee in its Discussion Paper considered that a committee of inspection is only necessary in very large and complex administrations and proposed that the word “may” should be substituted for the word “must”.⁵¹³

5.35 Most submissions supported this proposal.⁵¹⁴

5.36 Some respondents disagreed with the proposal, on the ground that the prescribed provisions are not mandatory, but merely a convenient set of clauses which can be adapted to particular circumstances.⁵¹⁵ However, the Legal Committee considers that the prescribed provisions should provide for the most common situation, so that administrators need only amend them in the minority of cases.

Recommendation 32. The prescribed provisions should provide for, rather than require, the establishment of a committee of inspection.

Other possible changes

5.37 The Legal Committee in its Discussion Paper invited submissions on any other changes that might usefully be made to the standard prescribed provisions.⁵¹⁶ No specific changes were suggested.

The *pari passu* principle

5.38 Some commentators have expressed concern that the principle of equal sharing between unsecured creditors (the *pari passu* principle) has not been incorporated into Part 5.3A.⁵¹⁷ The courts will only set aside a deed of company arrangement that discriminates against one or more unsecured creditors of the company if the creditors concerned can establish that the discrimination is oppressive, unfairly prejudicial or discriminatory in relation to them.⁵¹⁸ Under the voluntary administration voting

⁵¹² Corp Reg 5.3A.06, Schedule 8A, cl 11.

⁵¹³ Proposal 28, adopting the suggestion of GJ Hamilton, “Deeds of Company Arrangement: The Prescribed Provisions” (1995) 3 *Insolvency Law Journal* 67 at 84. See also P Lynch, “Drafting a Deed of Company Arrangement” (1995) 3 *Insolvency Law Journal* 115 at 121.

⁵¹⁴ Australian Credit Forum *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, VALRC *Submission*, Westpac *Submission*.

⁵¹⁵ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*.

⁵¹⁶ Issue 4.

⁵¹⁷ J O’Donovan, “The Harmer Reforms: Arranged Marriages and Extended Honeymoons” (1995) 8 *Corporate and Business Law Journal* 101 at 108. See also J O’Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,549-11,551, B Gordon of Clayton Utz (Perth) *Discriminatory Deeds of Company Arrangement and Erosion of the Pari Passu Principle* (1997) (unpublished), K Bennetts, “Inequality is Fairness: Reviewing the Decision in *Lam Soon Australia Pty Ltd (administrator appointed) v Molit (No 55) Pty Ltd*” (1997) 15 *Company and Securities Law Journal* 52, J O’Donovan, “Lessors and deeds of company arrangement” (1998) 6 *Insolvency Law Journal* 15 at 17-18.

⁵¹⁸ s 445D(1)(f)(i). *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139, 13 ACLC 885, *Lam Soon Australia Pty Ltd (admin apptd) v Molit (No 55) Pty Ltd* (1996) 22 ACSR 169, 14 ACLC 1,737. Also, in *Re Bartlett Researched Securities Pty Ltd (admin apptd)* (1994) 12 ACSR 707,

procedure, a deed can bind disadvantaged creditors even if they vote against the resolution that the company execute the deed.

5.39 The courts have upheld deeds of company arrangement that discriminate against one or more unsecured creditors where:

- the purpose of the deed was consistent with the objectives of Part 5.3A, and
- the alternative to the deed was the liquidation of the company and all unsecured creditors received at least as much as they would be likely to have received on liquidation.⁵¹⁹ This would usually be the case where a third party contributes funds which are used to provide a higher return under the deed to the preferred creditors.⁵²⁰

5.40 In addition:

- in assessing whether or not a deed is “unfair”, the courts look at the commercial objectives of the discrimination, not the relative treatment of creditors *inter se*⁵²¹
- the fact that the objectives of Part 5.3A could be achieved by less discriminatory means is irrelevant to the issue of fairness.

5.41 The Legal Committee in its Discussion Paper did not favour requiring all distributions of property under a deed of company arrangement to satisfy the *pari passu* principle.⁵²² It considered that this requirement could reduce desirable flexibility in drafting deeds of company arrangement. For instance:

- some creditors may intend to deal with a company under administration again in the future and therefore be prepared to accept less than their proportionate share
- deed administrators often have the power under a deed of company arrangement to promptly pay smaller creditors (for instance, those below \$1,000) in full, as administrative costs are reduced by limiting the number

the court was prepared to uphold a deed of company arrangement, notwithstanding that it gave one creditor a proportionately lower dividend than other creditors, on the basis that the return under the deed would be better than that in a liquidation. However, the court set aside the deed for other, unrelated, reasons.

⁵¹⁹ *Re Bartlett Researched Securities Pty Ltd (admin apptd)* (1994) 12 ACSR 707, *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139, 13 ACLC 885, *Lam Soon Australia Pty Ltd (admin apptd) v Molit (No 55) Pty Ltd* (1996) 22 ACSR 169, 14 ACLC 1,737.

⁵²⁰ As was the case in both *Re Bartlett Researched Securities Pty Ltd (admin apptd)* (1994) 12 ACSR 707 and *Lam Soon Australia Pty Ltd (admin apptd) v Molit (No 55) Pty Ltd* (1996) 22 ACSR 169, 14 ACLC 1,737.

⁵²¹ K Bennetts, “Inequality is Fairness: Reviewing the Decision in *Lam Soon Australia Pty Ltd (administrator appointed) v Molit (No 55) Pty Ltd*” (1997) 15 *Company and Securities Law Journal* 52 at 54. In *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139 at 152, 13 ACLC 885 at 895, the court refused to overturn a deed approved by the requisite majority of creditors that paid subcontractors 100c in the dollar, while other unsecured creditors were to receive 30c in the dollar, as it was for creditors to decide whether the future profitability of the companies concerned depended sufficiently on retaining the loyalty of the subcontractors to justify the higher payments to them.

⁵²² At 60-61.

of creditors that must be kept informed and sent notices of meetings and payments of dividends⁵²³

- related parties may be prepared to accept a lesser distribution.

5.42 Furthermore, the *pari passu* principle is appropriate for liquidations, but not necessarily for voluntary administrations, as equality of treatment is necessary in a winding up to stop creditors having to compete to be the first to wind a company up.⁵²⁴ Also, the courts may, in appropriate cases, terminate deeds which do not comply with the *pari passu* principle on the grounds that they are unjust and inequitable.

5.43 One respondent considered that it was not desirable to require that all deeds of company arrangement satisfy the *pari passu* principle.⁵²⁵

5.44 One commentator has proposed that creditors who have been discriminated against should have enhanced rights to approach the court. She proposed that in any application claiming discrimination, the onus of proof should be reversed by providing a rebuttable presumption of unfairness, to apply where the *pari passu* principle is violated by a deed of company arrangement without the consent of, for instance, a bare majority in value of the class of creditors receiving less than a rateable distribution under the deed.⁵²⁶ The Legal Committee does not agree. Such a presumption would unduly limit the flexibility of the voluntary administration procedure to tailor deeds of company arrangement to the needs of particular companies. A presumption of unfairness is particularly undesirable where the creditors concerned receive more than they would have received if the company had been wound up.

5.45 The Legal Committee maintains the view it expressed in its Discussion Paper that incorporation of the *pari passu* principle should not be made a prerequisite for a deed of company arrangement under Part 5.3A. It is desirable to permit maximum flexibility in drafting deeds. The courts have the power to terminate deeds that are oppressive or unfairly prejudicial to, or unfairly discriminatory against, particular creditors.⁵²⁷

Availability of the deed

⁵²³ The court in *Hamilton v National Australia Bank Ltd* (1996) 19 ACSR 647 at 674, 14 ACLC 1,202 at 1,224 indicated that giving smaller creditors a proportionately greater distribution would not constitute grounds for terminating a deed of company arrangement. See also R King, "Voluntary Administrations: Proposals For Change" in JPG Lessing & JF Corkery, *Corporate Insolvency Law* (The Taxation and Corporate Research Centre, 1995) 91 at 101.

⁵²⁴ R Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 1997) at 143 states: "Since the *pari passu* principle is concerned to ensure an equitable distribution of the company's estate among its creditors, it is confined to liquidation, for that is the only collective insolvency process which involves the distribution of assets among the general body of creditors."

⁵²⁵ Geoff McDonald *Submission*.

⁵²⁶ B Gordon of Clayton Utz (Perth) *Discriminatory Deeds of Company Arrangement and Erosion of the Pari Passu Principle* (1997) (unpublished).

⁵²⁷ s 445D(1)(f).

5.46 One commentator has proposed that once a deed of company arrangement has been executed, all creditors of the company (irrespective of whether their rights are affected by the deed) and all persons dealing or contemplating dealing with the company during the period of the deed should be entitled to receive a copy of the deed from the administrator upon payment of a prescribed fee.⁵²⁸

5.47 The Legal Committee considers that there should be no special provision for making deeds available, given that they can be obtained from the Commission database.⁵²⁹

Notification that a company is under a deed

5.48 Companies that are subject to a deed of company arrangement must indicate that fact on their public documents.⁵³⁰ This notification may have an adverse impact on the company's goodwill and reputation, and therefore its ability to continue trading and the amount which may ultimately be available for creditors.

5.49 The Legal Committee in its Discussion Paper proposed that the notification requirement should not apply to companies that have entered into pure composition deeds of arrangement (as defined in para 5.66 of this Report).⁵³¹ Those companies are no longer insolvent, as their creditors have accepted payments in full satisfaction of their claims. By contrast, a company that has entered into a moratorium or mixed deed of arrangement (also defined in para 5.66) remains insolvent until it pays its debts in accordance with the deed. Companies under pure composition deeds of arrangement may even be under new management.

5.50 Only one respondent supported the Discussion Paper proposal, subject to there being no likelihood of a default under the compromise.⁵³²

5.51 Many submissions opposed this proposal,⁵³³ for the following reasons.

- A deed of company arrangement may be set aside before it is fulfilled.⁵³⁴
- If the deed is terminated, unpaid post-deed creditors will have to share the unsecured assets with pre-administration creditors.⁵³⁵
- There would be unnecessary difficulties and complexities in classifying the various types of deeds. This could result in more restrictive forms of deeds.⁵³⁶

⁵²⁸ C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 24.

⁵²⁹ The administrator must lodge a copy of the deed with the Commission: s 450B(c).

⁵³⁰ s 450E(2).

⁵³¹ Proposal 39.

⁵³² Westpac *Submission*.

⁵³³ Allen Allen & Hemsley for QIDC *Submission*, Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission* (where the underlying management is the same), Ernst & Young *Submission*, Horwath *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁵³⁴ Allen Allen & Hemsley for QIDC *Submission*.

⁵³⁵ Ernst & Young *Submission*.

5.52 The Legal Committee no longer supports the proposal it made in its Discussion Paper exempting pure composition deeds from this notification requirement. It notes that most pure composition deeds do not release the debts until the distributions to creditors have been completed, in which case the deed should terminate soon after. Until that time, creditors should generally be entitled to have notice that the company is under a deed of company arrangement.

5.53 Some respondents suggested an alternative approach, namely that when a company's obligations are fully met under the deed, the deed administrator could thereafter issue a compliance certificate that could be the basis upon which notification is no longer required.⁵³⁷

5.54 Another respondent⁵³⁸ suggested that:

- a deed administrator who believes that the publication of the company's status would be prejudicial to creditors' interests should be able to convene a combined meeting of pre-administration and post-deed creditors to consider a resolution to allow the company to be exempted from the notification requirement⁵³⁹
- all creditors should have equal voting status on the basis of numbers and value
- the meeting should not be convened before the expiry of six months after the deed has been executed, to allow for a reasonable period for the company to prove itself and a reasonable representation of post-deed creditors to be incorporated into the voting.

5.55 The Legal Committee has reservations about granting creditors any discretion in this regard. The purpose of the notification is to advise prospective creditors. Existing creditors have had the benefit of this notification, but their decision to remove the notification requirement could prejudice prospective creditors.

5.56 The Committee considers that there may be circumstances where a continuing requirement for a company to put the words "subject to deed of company arrangement" on its public documents is inappropriate. The Committee recommends that, rather than leaving this matter to the discretion of the deed administrator or creditors, the company should have an express right to apply to the court for an order that these words need no longer appear on the company's public documents.⁵⁴⁰ An appropriate ground for a court application might be where, for instance, the deed

⁵³⁶ Ernst & Young *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁵³⁷ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

⁵³⁸ Ernst & Young *Submission*.

⁵³⁹ Geoff McDonald *Submission* also suggested that the obligation to include the phrase "subject to deed of company arrangement" should not apply where the creditors have consented.

⁵⁴⁰ In *Re Brashs Pty Ltd* (1994) 15 ACSR 477 at 483, 13 ACLC 110 at 115-116, Hayne J held that the court could exercise its general discretion under s 447A to exempt a company from the obligation to include the words "subject to deed of company arrangement" on its public documents.

administrator has received the money to be paid to creditors but it is necessary to resolve disputes about proofs of debt before the money can be distributed and the deed terminates.

Recommendation 33. A company should have an express right to apply to the court for an order that the company need not include the words “subject to deed of company arrangement” on its public documents.

Third party guarantees

5.57 The Legal Committee in its Discussion Paper noted a possible view that the acceptance of a deed of company arrangement extinguishes the liability of guarantors for debts of the company, by extinguishing the debt that is being guaranteed.⁵⁴¹ The Discussion Paper proposed that the law should make it clear that creditors’ adoption of a deed of company arrangement does not affect their rights against third parties, including their rights under guarantees or indemnities.⁵⁴²

5.58 Most submissions supported the proposal.⁵⁴³ Only the Law Council expressly disagreed on the ground that whether the extinguishment of the principal debt from the company prejudices the enforcement of a guarantee or indemnity is a matter of construction of the particular guarantee or indemnity and appears to be adequately resolved by the general law.⁵⁴⁴

5.59 The Legal Committee considers that certainty in this area is desirable. Creditors should be able to enforce a guarantee, provided that its terms permit them to do so in the event that the company (the principal debtor) goes into voluntary administration.

Recommendation 34. It should be made clear that a debt which is extinguished by entry into a deed of company arrangement, and which by its terms would have otherwise survived, is deemed not to have been extinguished for the purpose of enforcing a related guarantee or indemnity.

⁵⁴¹ At 44. This argument would not apply to an indemnity as the person in that case guarantees against loss and the creditor would have suffered a loss (the non-payment of the debt).

⁵⁴² Proposal 18. The Discussion Paper noted authority that this is the current law: *Gan v Sanders* (1994) 15 ACSR 298, *Hill v Anderson Meat Industries Ltd* [1972] 2 NSWLR 704, *Re Buildmat (Australia) Pty Limited* (1981) 5 ACLR 689, *M & G Oyster Supplies Pty Ltd v Nonchalant Pty Ltd* (1996) 19 ACSR 27 at 31, 14 ACLC 415 at 419-20, *Re Andersen’s Home Furnishing Co Pty Ltd* (1996) 14 ACLC 1,710, *Re Carey Builders Pty Ltd (subject to deed of company arrangement)* (1997) 23 ACSR 754. See also GJ Hamilton, “Deeds of Company Arrangement: The Prescribed Provisions” (1995) 3 *Insolvency Law Journal* 67 at 81-82, J O’Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,577.

⁵⁴³ Allen Allen & Hemsley for QIDC *Submission*, Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, Westpac *Submission*. See also J Gibbons & G Green, *Achieving a “fair and reasonable” outcome with voluntary administration*, Paper delivered to the IIR Corporate Insolvency Conference, Sydney 31 October 1996 at 19.

⁵⁴⁴ Ernst & Young *Submission* and VALRC *Submission* also considered that the case law on this issue is adequate, and that the proposal would merely clarify the law. However, they did not oppose the proposal.

Directors' guarantees

5.60 The Corporations Law restricts the enforcement of guarantees against directors or relatives of directors during the period of administration.⁵⁴⁵ The rationale behind this provision is that directors who have personally guaranteed the obligations of the company will be discouraged from appointing an administrator if the guarantee becomes enforceable immediately upon the appointment.⁵⁴⁶

5.61 The Legal Committee in its Discussion Paper raised the issue of whether this restriction should be extended to apply after the end of the administration, while a deed of company arrangement is in force.⁵⁴⁷ Commercial justifications for this approach are:

- without the extension, creditors' rights to take action against directors of the company could severely affect the company's ability to comply with the deed of company arrangement
- extension of the restriction would enable directors to perform their official functions better by avoiding their being preoccupied by their personal financial affairs.

5.62 However, the Legal Committee did not support this extended restriction. The period during which a deed operates may be quite lengthy. To permit any restriction on enforcing rights against guarantors during that period would significantly change the current policy of keeping the restrictions on the rights of creditors to a minimum.

5.63 One submission opposed the current restriction on enforcing guarantees against directors or their relatives during the period of administration.⁵⁴⁸ It noted the following problems that arise from this restriction:

- in some cases, directors use the moratorium on enforcement of their personal guarantees to dissipate their personal wealth

⁵⁴⁵ s 440J.

⁵⁴⁶ Explanatory Memorandum to the Corporate Law Reform Bill 1992 para 529. P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 11-12, 123-124 has queried this rationale. He considers that directors should have an interest in putting a company into administration at an early stage if Part 5.3A fulfils its purpose of increasing the chances of the company trading out of its difficulties and/or providing a better return to creditors than if the company were wound up. He points out that:

- the United Kingdom and United States voluntary administration laws do not prohibit the enforcement of third party guarantees
- the beneficiaries of these guarantees may be at a disadvantage in relation to other creditors of the guarantor who can take action against the guarantor during the administration.

⁵⁴⁷ The court in *Re Grenadier Constructions No 2 Pty Ltd (administrator appointed)* (1994) 12 ACLC 460 (also reported as *Stegbar Pty Ltd v Mayfield* (1993) 13 ACSR 354) took the view that the success of the deed of company arrangement was contingent upon the support of the directors for the continuing operations of the company and that it was therefore desirable for the restriction on enforcement of the directors' guarantees to continue. However, the court wrongly assumed that the current provision already applies to companies under deeds of arrangement.

⁵⁴⁸ Australian Finance Conference *Submission*.

- although it should be legally possible to trace those funds or property, in practice it is often difficult or impossible
- the potential costs which would need to be incurred in tracing the funds often militate against creditors utilising the recovery provisions.

5.64 The Legal Committee recognises these difficulties, but considers that they are outweighed by the benefit of encouraging directors to place their insolvent companies in voluntary administration. Also, the difficulties raised are practical problems which can be overcome where necessary.

Right to terminate a deed

5.65 Creditors can terminate a deed of company arrangement by passing a resolution at a meeting called for that purpose.⁵⁴⁹ The deed administrator must call that meeting if so requested in writing by at least 10%, by value, of the company's total creditors.⁵⁵⁰

5.66 The Legal Committee in its Discussion Paper considered it unsatisfactory that a relatively small number of creditors could force the administrator to convene a meeting of creditors and a majority of creditors at that meeting could terminate the deed of company arrangement, even where the company was complying with its terms.⁵⁵¹ The Committee proposed that the criteria for termination should differ for:

- *pure composition deeds of arrangement*, that is, those under which creditors accept payments in full satisfaction of their claims against the company, and
- *moratorium or mixed composition and moratorium deeds of arrangement*, that is, those under which the company agrees to trade on and pay creditors in full or in part over a period of time.

Pure composition deeds

5.67 Pure composition deeds of company arrangement may involve:

- an independent third party contributing capital to restore the company to solvency
- the company trading on under new controllers.

5.68 These deeds require the administrator to deal with residual administrative issues before a final distribution to deed creditors can be achieved, for instance:

- administration of claims against the deed fund
- adjudication upon those claims
- litigation of appeals from adjudication, and
- final distribution of deed proceeds to creditors.

⁵⁴⁹ s 445C(b).

⁵⁵⁰ s 445F(1).

⁵⁵¹ At 71.

5.69 The Legal Committee considered that, once creditors have accepted a compromise of their debts under a pure composition deed of company arrangement, they should not have the right, for an indefinite time, either to terminate the deed or to apply to the court to declare the deed void. Prospective purchasers may be reluctant to make significant injections of funds in these circumstances.

5.70 The Legal Committee in its Discussion Paper proposed that a dissident creditor could apply to the court to terminate a pure composition deed of company arrangement within 21 days from the creditors' resolution to accept the deed.⁵⁵² The court should have to take into account the rights of third parties in making an order to terminate a deed.

5.71 Some submissions supported the proposal.⁵⁵³ Most submissions did not support it,⁵⁵⁴ for the following reasons.

- There would be unnecessary difficulties and complexities in classifying the various types of deeds. This could result in more restrictive forms of deeds.⁵⁵⁵
- Termination of deeds where there has been no failure to perform has not been a practical problem.⁵⁵⁶
- The proposal would remove the creditors' power to determine the future of their interests. Most composition deeds do not release the debts until the distributions to creditors have been completed, in which case the deed should terminate soon after. Creditors who have not been paid what they have been promised in the deed should be able to terminate the deed even if the period for payment has not yet expired.⁵⁵⁷

5.72 Taking these arguments into account, the Legal Committee now agrees that it would be inappropriate to limit the right to terminate a pure composition deed of company arrangement to 21 days from the creditors' resolution to accept the deed.

Moratorium and mixed deeds

5.73 The Legal Committee in its Discussion Paper proposed that:

- creditors should only be able to terminate a moratorium or mixed deed by resolution if there has been a material breach of the deed that has not been rectified before creditors pass the resolution

⁵⁵² Proposal 33. Cf s 205(12).

⁵⁵³ Allen Allen & Hemsley for QIDC *Submission*, Australian Credit Forum *Submission*, Westpac *Submission*.

⁵⁵⁴ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁵⁵⁵ Australian Institute of Credit Management *Submission*, Ernst & Young *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁵⁵⁶ Geoff McDonald *Submission*, VALRC *Submission*.

⁵⁵⁷ Ernst & Young *Submission*.

- creditors should have a right to apply to the court to terminate a moratorium or mixed deed where there has been material prejudice to their interests.⁵⁵⁸

The court should have to take into account the rights of third parties in making an order to terminate a deed.

5.74 Some submissions supported this approach.⁵⁵⁹ Others opposed it on the basis that the current law was adequate.⁵⁶⁰

All deeds

5.75 The Legal Committee considers that it is desirable to clarify the circumstances in which creditors can terminate deeds of company arrangement (whether pure composition, moratorium or mixed deeds) by resolution.

5.76 Creditors should only be entitled to terminate a deed by resolution following a material breach of the deed that has not been rectified before the resolution has been passed.

5.77 The current provision for a deed to terminate in circumstances contemplated by the deed itself should remain.⁵⁶¹ The current provision for a court application by a creditor of the company, the company, or any “other interested person” should also remain.⁵⁶² A deed administrator could apply as an “other interested person”.⁵⁶³ A

⁵⁵⁸ Proposal 33.

⁵⁵⁹ Allen Allen & Hemsley for QIDC *Submission*, Australian Credit Forum *Submission*, Horwath *Submission*, Westpac *Submission*. Other submissions that commented on the proposal to make separate provision for pure composition deeds of company arrangement did not comment on this proposal.

⁵⁶⁰ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*.

⁵⁶¹ s 445C(c).

⁵⁶² ss 445C(a), 445D(2).

⁵⁶³ s 445D(2)(c). This resolves the concern raised in the Horwath *Submission* that a deed administrator should have a power to apply to the court for termination of the deed where the creditors have not resolved to terminate the deed, but the deed administrator believes it to be in the interests of the public for the deed to be terminated.

court should have no power to terminate a deed without taking into account the rights of third parties.

Recommendation 35. Any deed of company arrangement should only terminate:

- through a resolution of creditors following a material breach of the deed that has not been rectified before the resolution is passed
- in circumstances contemplated by the deed itself, or
- by an order of the court, on application by a creditor of the company, the company, or any other interested person. The court, in deciding whether to terminate a deed, should be required to take into account the rights of third parties.

Chapter 6. Administrators and deed administrators

This Chapter discusses the information that administrators should give to creditors, the administrator's duty of investigation, the administrator's personal liability and right of indemnity, the powers of administrators and deed administrators over the company's property and shares and the notification obligations of administrators and deed administrators.

Administrator's statement of interest

6.1 The Legal Committee in its Discussion Paper proposed that an administrator should be required to make a declaration containing material information about his or her professional, personal or business relationships (if any) with the company or its officers, members or creditors.⁵⁶⁴ Currently, there is no such requirement.

6.2 The Discussion Paper argued that:

- it is important that the administrator either be independent of the company and particular creditors or alternatively that creditors generally be made aware of any relationships between them, given that these relationships could impede the administrator's independence
- the time and cost involved in preparing such a statement are minimal
- the administrator must in any case consider this issue before accepting appointment.⁵⁶⁵

6.3 The Law Reform Commission considered that a person who consents to being appointed as an administrator should be required to lodge with the regulator a statement that declares:

- “(a) any prior or present professional or other association that the person, or that a partner or employee of the person, has had or has:
- (i) with the company or with a company that is or has been a related company; or
 - (ii) with a member, officer or creditor of the company or of a company that is or has been a related company,
- in respect of the affairs of the company, so far as they are known to the person, and discloses fully and truly the circumstances of the association”.⁵⁶⁶

6.4 Many submissions supported this proposal.⁵⁶⁷

6.5 One of these submissions suggested that there should be a prescribed form that includes a declaration that reasonable enquiries into any association have been made,

⁵⁶⁴ Proposal 8.

⁵⁶⁵ At 26.

⁵⁶⁶ ALRC 45, vol 2, s VA10. See also vol 1, para 78.

⁵⁶⁷ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, Ernst & Young *Submission*, Horwath *Submission*, Law Council of Australia *Submission*, Westpac *Submission*.

having regard to the circumstances of the administrator. This was intended to deal with administrators who are members of national or even international partnerships consisting of many partners with numerous associations.⁵⁶⁸ The Legal Committee does not agree with prescribing a form for the administrator's statement. Administrators should have flexibility in deciding how to satisfy their legislative duties. However, it would be reasonable to limit the disclosure requirement to those matters that the administrator can discover by making reasonable enquiries. This limitation would still be stricter than a requirement for administrators merely to disclose associations of which they are aware, but would excuse them from liability for not disclosing something of which they could not reasonably be aware.

6.6 The Legal Committee originally proposed that the statement of interest be sent to creditors with the notice convening the first meeting. Some submissions considered that this statement should instead be tabled at the meeting of creditors to avoid unnecessary costs and confusion. Notices that are too bulky may not be fully read.⁵⁶⁹ Some submissions considered that the statement of interest should be incorporated in the administrator's consent to act, to be tabled at the first meeting of creditors.⁵⁷⁰

6.7 The Legal Committee now agrees that the administrator's statement of interest need only be tabled at the first meeting of creditors.

6.8 The Legal Committee notes that, before October 1996, a prospective trustee under Part X of the Bankruptcy Act was required to make a similar statement of interest.⁵⁷¹ The Explanatory Memorandum to the amending legislation which repealed this requirement justified its discontinuance "because it has not proved to be of practical utility, and adds to the costs of administration".⁵⁷² The Legal Committee considers that, in the context of corporate voluntary administration, a statement of interest by the administrator would be material information for creditors and would not unduly add to administration costs. For these reasons, it recommends the introduction of a disclosure requirement, notwithstanding the repeal of the comparable Bankruptcy Act provision.

6.9 One commentator has proposed⁵⁷³ that an administrator should be required to send with the notice to creditors a statement confirming that he or she is not disqualified from acting as administrator.⁵⁷⁴ The Legal Committee considers that a statement to this effect is unnecessary, given that it is an offence for administrators to act while disqualified.

Recommendation 36. All administrators (whether appointed under s 436A, 436B or 436C) should be required to table a statement of interest at the first meeting of creditors. The statement should disclose any professional, personal and business

⁵⁶⁸ Ernst & Young *Submission*.

⁵⁶⁹ Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*.

⁵⁷⁰ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, VALRC *Submission*.

⁵⁷¹ Bankruptcy Act s 215A(1)(c)(ii) (repealed in 1996).

⁵⁷² Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill 1996 para 158.2.

⁵⁷³ C Hitchen, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 9.

⁵⁷⁴ Subsection 448C(1) sets out the circumstances in which an administrator is disqualified.

relationships of the administrator and his or her firm with the company or its officers, members or creditors that the administrator knew or should have discovered upon reasonable inquiry, including as an accountant or other professional adviser (other than the relationship arising merely from the company's request that the person be an administrator).

Formulation of proposals

6.10 One respondent⁵⁷⁵ suggested that administrators could be required upon their appointment to advertise, seeking proposals in relation to the company and its business. The Legal Committee does not agree, as:

- public advertising may be inappropriate in certain circumstances
- the administrator already has a duty to realise assets in the most advantageous way
- the means of fulfilling this duty is a matter for the administrator to determine.

6.11 Given these considerations, it would be unnecessary to require the administrator to advertise.

Administrator's investigation of affairs

6.12 An administrator has a duty to investigate the company's business, property, affairs and financial circumstances and form an opinion about what course of action would be in the interests of creditors (namely entry into a deed of company arrangement, the liquidation of the company or the termination of the administration).⁵⁷⁶ The administrator must provide that opinion to creditors.⁵⁷⁷

6.13 One commentator has suggested that it is difficult for administrators to determine the appropriate level of investigation to form that opinion.⁵⁷⁸ It may be particularly difficult to ascertain what creditors might receive in a possible liquidation. For instance, it may be difficult to determine:

- creditors' claims (particularly future or contingent claims, or claims for damages)
- the realisation values of assets
- claims against present or former directors or officers for breach of duty (including insolvent trading) or breach of trust
- actions for recovery of preferences
- claims for damages against third parties arising out of commercial transactions.

⁵⁷⁵ David Kerr *Submission*.

⁵⁷⁶ s 438A.

⁵⁷⁷ s 439A(4)(b).

⁵⁷⁸ C Hinchey, *Voluntary Administrations: A Discussion of Reforms*, Paper delivered to the 1997 National Conference of the Insolvency Practitioners Association of Australia (12-13 June 1997) at 14-16.

6.14 The use of considerable company funds to investigate these matters may be especially undesirable where a deed of company arrangement appears to be the best option. Also, an administrator may feel compelled to pursue an investigation suggested by a particular creditor, regardless of its merits, merely to have a response if the creditor raises the matter at the major meeting.

6.15 The commentator suggested a more specific formulation of the administrator's duty to investigate, as a duty to conduct such investigations as are reasonable in the circumstances of the administration, having regard to:

- . the nature of the information reasonably at the administrator's disposal
- . the funds at his or her disposal
- . the comparative benefits to the creditors as a whole in conducting the investigations
- . whether in all the circumstances the investigations are unduly onerous, or
- . any other good reason.

6.16 The commentator proposed that, if an administrator is unable, or considers it inappropriate, to commence or exhaust investigations in relation to a particular matter, the administrator should be required to state fully in the report to creditors:

- . the investigations conducted
- . the investigations not conducted or concluded
- . the reasons why investigations were not conducted or concluded
- . the impact which the incomplete investigations (or the investigations not conducted) may have on the creditors' capacity to make an informed decision about whether it would be in the creditors' interests for the company to be wound up.

6.17 The Legal Committee, while supporting the principle that an administrator should not have to undertake an investigation that is excessive in light of the company's financial circumstances, regards detailed legislative prescription of the extent of the duties of an administrator in this respect as unnecessary. The courts "have regard to the tight time limits imposed upon an administrator under Part 5.3A in determining the extent of the administrator's duty to investigate and the amount of information to be made available to creditors under Part 5.3A".⁵⁷⁹ The court in one case noted that:

"an administrator, constrained as he or she is by the time limits imposed under the Part, cannot carry out a detailed investigation of a company in the same way as can a liquidator, and accordingly the administrator's actions must be looked

⁵⁷⁹ P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 91. See also JO'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,488, 11,512, *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.

at in the light of that more restricted range of activities which are available to him.”⁵⁸⁰

6.18 The courts therefore provide administrators with sufficient flexibility to tailor any investigation to the circumstances of a particular administration.

Transfer of shares with the administrator’s approval

6.19 Any transfer of shares in a company or alteration in the status of members of a company that is made during the administration of the company is void, unless the court otherwise orders.⁵⁸¹ This provision may restrict the efficient operation of Part 5.3A, particularly where the assets of the company are being acquired through the transfer of shares.⁵⁸² By contrast, transfers of shares in a voluntary winding up are permitted with the consent of the liquidator.⁵⁸³

6.20 The Legal Committee in its Discussion Paper proposed that there should be no restriction on transferring shares or altering the status of the members of a company under administration, if the transaction:

- takes place with the consent of the administrator, and
- is, in the administrator’s opinion, in the best interests of the creditors of the company.⁵⁸⁴

6.21 Most submissions supported this proposal.⁵⁸⁵ One of these respondents said that the court should only be involved if there is an appeal from an administrator’s decision not to consent to a transfer.⁵⁸⁶ The Legal Committee agrees. It is desirable to avoid a court application where possible. An application should only be made by a prospective transferor or transferee of shares who has first unsuccessfully sought the approval of the administrator for the transfer. The administrator should have standing to be heard on any court application.

6.22 Two submissions⁵⁸⁷ considered that the ability to transfer shares during an administration should depend on the consent of the creditors, not the administrator, for the following reasons.

⁵⁸⁰ *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 17 ACSR 139 at 145, 13 ACLC 885 at 890.

⁵⁸¹ s 437F.

⁵⁸² Geoff McDonald *Law Reform Submission*. That Submission pointed out that these transfers may be necessary to preserve income tax losses for the benefit of the purchaser. See also P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 89-90.

⁵⁸³ s 493(2).

⁵⁸⁴ Proposal 10.

⁵⁸⁵ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*, Westpac *Submission*.

⁵⁸⁶ Ernst & Young *Submission*.

⁵⁸⁷ Australian Bankers’ Association *Submission*, Westpac *Submission*.

- Creditors should be able to influence ownership where their financing documents contain events of default related to changes in ownership.⁵⁸⁸
Legal Committee response. Only some creditors would have these financing agreements. A vote of all creditors may not be the most appropriate way to protect their interests.
- Some administrators may accede to shareholder proposals that are contrary to the interests of creditors.⁵⁸⁹
Legal Committee response. The Legal Committee proposes that the administrator may only approve a transaction if, in the administrator's opinion, it is in the best interests of the creditors of the company. This would be additional to the general duty of administrators, who are independent insolvency practitioners, to act in the interests of creditors.

6.23 The Legal Committee therefore considers that the administrator, rather than creditors, should be permitted to consent to share transfers or other alterations in the status of the company's members.

Recommendation 37. The administrator of a company should be permitted to consent to a transfer of shares in the company or an alteration in the status of the company's members if such a transaction is, in the administrator's opinion, in the best interests of the creditors of the company. The court should continue to have the power, on application by the prospective transferor or transferee of the shares, to consent to a transfer of shares or an alteration in the status of a company's members. An application to the court should only be permissible where the administrator has refused to consent to the transfer.

Administrator's fees

6.24 Currently, an administrator's fees can only be determined:

- by resolution of the company's creditors at the major meeting of creditors or at a meeting of creditors to seek a variation of the deed of company arrangement, or
- if creditors do not so resolve, by the court on application by the administrator.⁵⁹⁰

6.25 The Legal Committee in its Discussion Paper considered that this provision was too limited.⁵⁹¹ If the specified creditors' meetings are not held, no quorum is obtained or the matter is not resolved, the administrator must seek court approval for the payment of the fees. The process of obtaining court approval is administratively burdensome.

6.26 The Committee in its Discussion Paper proposed that:

⁵⁸⁸ Westpac *Submission*.

⁵⁸⁹ Australian Bankers' Association *Submission*.

⁵⁹⁰ s 449E. The major meeting of creditors is convened under s 439A. A meeting to vary a deed is convened under s 445F.

⁵⁹¹ At 77.

- an administrator should be able to have fees approved at any meeting of creditors, where the creditors have notice of that matter
- the administrator should be able to convene a meeting of creditors for this specific purpose
- if the meeting is convened after the administration has concluded, the cost of the meeting should be an expense of the administrator personally.⁵⁹²

6.27 Many submissions supported this proposal.⁵⁹³ Comments dealt with three aspects:

- the method for approving an administrator's remuneration
- the duty for administrators to disclose their remuneration to creditors
- priority for an administrator's remuneration.

Method for approving administrators' remuneration

6.28 One respondent⁵⁹⁴ proposed that, to achieve consistency between different forms of insolvency administration, the procedure for setting administrators' fees should be the same as that for setting liquidators' fees,⁵⁹⁵ namely:

- by agreement between the administrator and the committee of creditors, or
- if there is no committee of creditors, or the administrator and the committee do not agree - by resolution of the creditors, or
- if no resolution is passed - by the court.

6.29 The Legal Committee considers that administrators' remuneration should be able to be approved:

- by agreement between the administrator and the committee of creditors
- by resolution of creditors generally where they have notice that this matter is to be considered, including at the major meeting⁵⁹⁶ or any special meeting called for that purpose, or
- by the court.⁵⁹⁷

6.30 If a meeting of creditors is to be convened for the purpose of considering remuneration after the administration has concluded, the cost of the meeting should be

⁵⁹² Proposal 38.

⁵⁹³ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Westpac *Submission*.

⁵⁹⁴ SLD Consultants Pty Ltd *Submission*.

⁵⁹⁵ s 473(3).

⁵⁹⁶ The VALRC *Submission* proposed that the existing provision for a resolution to approve the administrator's fees to be submitted at the major meeting of creditors (s 449E(1)(a)) should remain.

⁵⁹⁷ The Legal Committee considers that this recommendation is consistent with the approach adopted in *Report of the Working Party on the Review of the Regulation of Corporate Insolvency Practitioners* (June 1997) (paras 1.35-1.40, Chapter 10).

met by the administrator personally, without any right of indemnity out of the company's property.

6.31 One respondent⁵⁹⁸ suggested that, where the creditors (either collectively or through the committee of creditors) do not approve the administrator's remuneration, that remuneration should be prescribed by regulation.⁵⁹⁹ The Legal Committee does not support legislative prescription of fees, even on a default basis, as it is too inflexible. Where agreement cannot be reached, the matter can be determined by the court on the application of the administrator.

6.32 Another respondent considered that the Corporations Law should be amended to permit the Commission to apply to the court for a review of the remuneration of an administrator or a deed administrator (for instance, to cover the situation where a deed includes an open-ended remuneration clause which does not cap the amount of the fee to be taken on a monthly basis).⁶⁰⁰ The Legal Committee does not support this suggestion. The voluntary administration provisions already permit creditors to approve an administrator's fees on a capped basis. Also, it would impose a significant regulatory burden on the Commission to monitor proposed remuneration arrangements.

Administrators' duty to disclose their remuneration to creditors

6.33 One respondent proposed that any remuneration formula should disclose the total projected amount, not simply the rate, of remuneration, thereby ensuring that creditors are fully informed about the total costs of the administration.⁶⁰¹ The Legal Committee agrees with the general principle of full disclosure. It considers that an administrator's report to creditors⁶⁰² should include a disclosure of the administrator's past and projected fees and expenses and, if there is to be a deed of company arrangement and on the assumption that the administrator becomes the deed administrator, the deed administrator's projected fees and expenses. The Legal Committee acknowledges that projected fees could only be an estimate, not a binding assessment, of actual fees. It should be left to administrators to determine the appropriate method for estimating their projected fees. The purpose of a general disclosure obligation would be to give creditors some broad indication of possible fees.

6.34 Another respondent proposed that administrators should be obliged to set out the basis of their fees at the first meeting, as creditors should receive this information at the earliest possible opportunity. However, the remuneration should not be fixed until the major meeting, where the actual quantum of fees should be more accurately assessable.⁶⁰³ The Legal Committee notes that administrators may provide creditors with this information at the first meeting, either on their own initiative or at the

⁵⁹⁸ David Kerr *Submission*.

⁵⁹⁹ cf Bankruptcy Act s 162(4), reg 8.08.

⁶⁰⁰ SLD Consultants Pty Ltd *Submission*.

⁶⁰¹ Ernst & Young *Submission*.

⁶⁰² s 439A(4).

⁶⁰³ VALRC *Submission*.

request of creditors. However, a statutory requirement may be too inflexible. It should suffice if the fees are fully disclosed in the manner proposed by the Legal Committee.

Priority for administrator's remuneration

6.35 One commentator⁶⁰⁴ has identified an apparent inconsistency between the lien on a company's property that an administrator has to cover the administrator's remuneration⁶⁰⁵ and the lower priority that an administrator's remuneration has in a liquidation.⁶⁰⁶

6.36 That commentator suggested two contrasting approaches to resolve that inconsistency where a company under administration subsequently goes into liquidation:

- *administrator's first priority*: the Corporations Law should specifically provide that administrators retain their priority over all of the assets of the company (through a lien), with the assets available to the liquidator being subject to that priority, or conversely
- *administrator's deferred priority*: the Corporations Law should specifically provide that the administrator's priority is determined under the liquidation provisions (s 556) rather than Part 5.3A, apart from the funds held by that administrator in the administrator's bank account.

6.37 In a subsequent submission to the Legal Committee, that commentator proposed that, in any event, law reform was necessary to avoid possible disputes about who has control of a company's assets where an administrator is superseded either by a replacement administrator or by a liquidator. For instance, the original administrator may seek to retain control of the company's assets by virtue of the lien, to secure payment of his or her remuneration. The replacement administrator or liquidator may claim a right to control the same assets for the purpose of performing his or her functions. The commentator suggested that a clarification of the respective priorities of these parties might involve limiting the administrator's lien rights to particular assets under his or her control (cash at bank, stock acquired by the administrator, book debts generated by the administrator).

6.38 The Legal Committee considers that there may be no inconsistency between the two current provisions. In its view, the administrator's lien would not extend to property gathered in by a liquidator in a winding up, including unfair preferences.⁶⁰⁷ If the property subject to the administrator's lien proves insufficient to meet the full amount of the remuneration, and the administrator must rely on property gathered in by the liquidator, the administrator would have a deferred priority for the shortfall.

⁶⁰⁴ Geoff McDonald *Submission to Treasury* (June 1997).

⁶⁰⁵ s 443F.

⁶⁰⁶ s 556(1)(de), 556(2) definition of "deferred expenses".

⁶⁰⁷ A similar view is taken by M Brown, "The Priority of the Expenses and Remuneration of an Administrator or Provisional Liquidator in the Winding-up of a Company" (1998) 9 *Journal of Banking and Finance Law and Practice* 126.

6.39 Also, the Legal Committee is reluctant to recommend any statutory limitation on the administrator's current lien rights, in the absence of clear evidence that the current law is producing unjust or unworkable results. The Legal Committee prefers that the courts develop the law in this area.

Recommendation 38. Administrators should be able to obtain approval of their fees:

- . by agreement between the administrator and the committee of creditors
- . by resolution of creditors generally where they have notice that this matter is to be considered, or
- . by the court.

If a meeting of creditors is convened for this purpose after the administration has concluded, the cost of the meeting should be an expense of the administrator personally, without any right of indemnity out of the company's property.

The administrator's report to creditors should include a disclosure of the administrator's past and projected fees and expenses.

Administrator's personal liability

6.40 Administrators are liable for debts they incur in the exercise of their functions or powers.⁶⁰⁸ They cannot contract out of those debts, but have an indemnity out of the company's property for them.⁶⁰⁹

6.41 The Legal Committee in its Discussion Paper considered whether administrators should be permitted to contract out of personal liability.⁶¹⁰ If so, it would be a matter for creditors to determine in each instance whether they were prepared to contract with the company on this basis.

6.42 The Legal Committee in its Discussion Paper proposed that administrators should continue to have personal liability.⁶¹¹ The Committee agreed with the position taken by the Law Reform Commission, which considered it "essential to provide [a reasonable assurance of payment] to creditors by requiring the administrator to be personally liable".⁶¹² In deciding to impose personal liability on administrators, the Law Reform Commission took the following matters into account:

- . the criticisms of official management and, in some cases, schemes of arrangement for offering no assurance that persons who engaged in

⁶⁰⁸ s 443A(1). Under general agency law, an agent acting for a disclosed principal would not ordinarily incur personal liability: P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 15, 148.

⁶⁰⁹ s 443A(2) (this provision also implies that administrators may obtain an indemnity from third parties). The administrator's right of indemnity and associated lien are dealt with in ss 443D-443F.

⁶¹⁰ At 49-50.

⁶¹¹ Proposal 21.

⁶¹² ALRC 45, vol 1, para 88.

business with a company under either type of administration would be paid any debt resulting from that business

- the opportunity, albeit brief, for insolvency practitioners who act as administrators to make some preliminary assessment of the financial position of the company before consenting to appointment as an administrator
- the lack of any compulsion for administrators to continue the business of a company or seek credit in doing so⁶¹³
- the administrator's indemnity out of the company's assets for debts incurred.

6.43 Most submissions supported the proposal to retain personal liability.⁶¹⁴ One submission opposed it.⁶¹⁵

6.44 The Legal Committee favours retention of an administrator's current personal liability. Administrators should not be permitted to contract out of that liability.

6.45 A recent ASC Research Paper noted attempts by some administrators to circumvent personal liability for debts incurred during the administration by using a licensing agreement with the directors of the company that permits the directors to use the company's assets to continue trading in the directors' names.⁶¹⁶ The Research Paper raised the possibility of restricting or prohibiting this practice.

6.46 The Legal Committee does not consider that any legislative change is necessary to deal with this practice. It questions whether administrators could lawfully contract out of their statutory personal liability.⁶¹⁷ Also, any administrators who behave in the way described might be jeopardising their registration.

6.47 Another issue raised by one submission is whether persons operating a company under a deed of company arrangement should have any personal liability to creditors dealing with that company during that period.⁶¹⁸ Prior to a recent amendment to the Corporations Law, these creditors had no admissible claim where the company

⁶¹³ The Explanatory Memorandum to the Corporate Law Reform Bill 1992 (para 479) considered that the administrator's power under s 437A(1)(c) to terminate or dispose of all or part of a company's business would be "a useful means by which an administrator can limit his or her personal liability under ... section 443A for the debts, liabilities and obligations he or she incurs, in circumstances where the administrator comes to the decision that the company can only continue to trade at a loss and the company's assets are likely to be insufficient to satisfy the indemnity to be provided by ... section 443D for those debts, liabilities and obligations".

⁶¹⁴ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission* (provided the debts are incurred with the administrator's written authority), VALRC *Submission*, Westpac *Submission*.

⁶¹⁵ Geoff McDonald *Submission*. Also, Horwath *Submission* suggested that administrators should be permitted to contract out of personal liability in certain circumstances.

⁶¹⁶ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 7.317.

⁶¹⁷ s 443A.

⁶¹⁸ Major Airconditioning & Refrigeration Suppliers *Submission*.

subsequently went into liquidation⁶¹⁹ and no other right of recovery against the company. The Corporations Law now provides that these creditors stand on an equal footing with other unsecured creditors.⁶²⁰ Given this, the Legal Committee considers that there is no reason to impose personal liability on the deed administrator.

Recommendation 39. Administrators should continue to be personally liable for debts incurred in the performance or exercise of any of their functions and powers.

Administrator's liability to employees

Adoption of employment contracts by administrator

6.48 Contracts of employment do not terminate automatically when an administrator is appointed to a company.⁶²¹ They are still enforceable against the company. Also, administrators are personally liable for any employment contract that they adopt.

6.49 In Australia, adoption requires positive action by the administrator. The mere failure by administrators to terminate employment contracts on their appointment does not constitute adoption. However, any "variation, novation or otherwise" of the original contract by the administrator constitutes adoption.⁶²²

6.50 The Legal Committee in its Discussion Paper noted the possibility that the mere payment of wages by the administrator may constitute adoption of the employment contract in full.⁶²³ The consequences of any adoption may be extremely onerous for the administrator who would then become personally liable for all accrued rights under that contract, including for outstanding holiday pay, long service leave and any retrenchment pay.

6.51 The Legal Committee therefore proposed that an administrator should not be taken to have adopted any employment contract of the company unless the administrator does so expressly in writing.⁶²⁴ Mere payment of wages by the administrator, for instance, should not constitute adoption. The Committee noted that a company's employees have rights to be paid in priority to other creditors for wages, leave and other entitlements if the company goes into liquidation.⁶²⁵

⁶¹⁹ *Re Crawford House Press Pty Ltd* (1995) 17 ACSR 295, 13 ACLC 874.

⁶²⁰ s 553(1A).

⁶²¹ *Powdrill v Watson* [1995] 2 All ER 65 at 82.

⁶²² *Green v Giljohann* (1995) 17 ACSR 518 at 523.

⁶²³ At 50.

⁶²⁴ Proposal 22. Compare the UK Insolvency Act 1986 s 19 which provides for administrators to be liable for contracts adopted by them or their predecessors. The liability is only for the period following adoption of the contract. That provision does not specify what will constitute adoption, but does state that an administrator "is not to be taken to have adopted a contract of employment by reason of anything done or omitted to be done within 14 days after his appointment".

⁶²⁵ s 556(1)(e), (f), (g), (h).

6.52 Many submissions supported this proposal.⁶²⁶ Two respondents opposed it, on the ground that the current law is sufficiently clear on this point.⁶²⁷

6.53 The Legal Committee confirms its proposal, subject to the qualification that any express adoption of an employment contract should only relate to wages, leave and other entitlements that accrue during the period of the administration. This principle should prevail over any inconsistent Federal, State or Territory legislation regulating employment contracts.

Liability for employees' wages

6.54 A related issue is whether there should be a specific exception to the principle that administrators may adopt employment contracts only by express writing, whereby they are automatically personally liable for the wages earned by the company's employees during the period of administration. There appears to be considerable doubt about whether the administrator is currently so liable unless the administrator specifically adopts the contract.⁶²⁸

6.55 An argument for imposing this automatic liability is that it would be consistent with the principle underlying s 443A that the administrator is liable for services rendered during the administration (despite possible technical arguments that wages fall outside that provision⁶²⁹). One respondent supported this automatic liability.⁶³⁰

6.56 An argument against imposing automatic liability is the potential size of the wages bill and therefore the possible personal liability of the administrator, although the administrator has a right of indemnity against the company's assets.

6.57 On balance, the Legal Committee considers that an administrator of a company should be personally liable for the wages of the company's employees who continue to provide services with the administrator's express or implied authority. An administrator should not be taken to have given implied authority for the provision of services by an employee of whom the administrator was unaware, provided that the administrator has taken all reasonable steps to identify all the company's employees.⁶³¹

⁶²⁶ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, Westpac *Submission*.

⁶²⁷ Law Council of Australia *Submission*, VALRC *Submission*.

⁶²⁸ C Hammond, 'Are Receivers and Administrators Liable for the Wages of Company Employees Retained after their Appointment?' (1997) 5 *Insolvency Law Journal* 136. Wages may not constitute a debt that the administrator incurs for services rendered under s 443A, as the administrator is not taken to have adopted the employment contract.

⁶²⁹ *Ibid*.

⁶³⁰ Ernst & Young *Submission*.

⁶³¹ Similarly, the Ernst & Young *Submission* proposed that the administrator be personally liable for all services that the administrator has authorised. In this respect: "There should be a presumption that all services rendered by employees, acting under the terms of their contracts of employment, are authorised services. It will be up to the administrator to show that presumption is rebutted. This should cover the situation where there may be employees, unknown to the administrator after making reasonable enquiries, interstate or overseas, who the administrator would have terminated had he or she known of their existence."

Recommendation 40. An administrator should not be taken to have adopted any employment contract entered into by the company unless the administrator does so expressly in writing. It should be made clear that any adoption of an employment contract only relates to entitlements that accrue during the period of the administration. Any Federal, State or Territory legislation relating to employment contracts that is inconsistent with this recommendation should be overridden.

An administrator of a company should be personally liable for the wages of the company's employees who continue to provide services with the administrator's express or implied authority. An administrator should not be taken to have given implied authority for the provision of services by an employee of whom the administrator was unaware, provided that the administrator has taken all reasonable steps to identify all the company's employees.

Administrator's rent-free period

Liability for first week's rent

6.58 An administrator has a week after appointment to decide whether the company will continue to use, occupy or be in possession of property before the administrator becomes personally liable for rent and other payments during the administration.⁶³²

6.59 The Legal Committee in its Discussion Paper did not favour a suggestion that an administrator should be personally liable for the first week's payment, as well as continuing payments, if the administrator decides that the company will continue to use the rented property.⁶³³ Creditors retain a right to payment from the company, which is liable for rental payments throughout the administration period, including the first week.⁶³⁴

6.60 No submissions disagreed with the Legal Committee's view. One respondent specifically agreed.⁶³⁵

⁶³² s 443B(2).

⁶³³ At 51.

⁶³⁴ ALRC 45, vol 1, para 90.

⁶³⁵ Geoff McDonald *Submission*.

No liability where administrator unaware

6.61 An administrator can become personally liable for lease payments even where the administrator is unaware of the existence of the lease. This situation may occur where, for instance:

- the company's books and records are inadequate, or
- the company's directors conceal information.

6.62 The Legal Committee in its Discussion Paper considered whether the administrator should only be liable when the administrator is aware, or ought reasonably to have been aware, of the rental commitment.⁶³⁶ This change would prompt leasing companies to adopt standard procedures to ensure that they promptly seek information on the appointment of an administrator and notify the administrator of the lease commitments as soon as they become aware of the administration.

6.63 The Legal Committee did not consider this change appropriate. Owners of property used or occupied by a company should not be disadvantaged in this way by the company going into voluntary administration. Also, administrators have a right of indemnity against the company's property. The Law Reform Commission rejected a suggestion that administrators should only become liable for leased property if they have been notified of the relevant agreement by the owner of the property.⁶³⁷ The Legal Committee also notes that the court already has a power to excuse an administrator from personal liability.⁶³⁸ The court could use this power in appropriate circumstances to relieve an administrator from personal liability under a particular lease.⁶³⁹

Administrator's notification to owners or lessors

6.64 One respondent⁶⁴⁰ considered that administrators should have a greater obligation to ensure that owners or lessors of equipment who have been notified that the company does not propose to exercise rights in relation to the equipment can quickly and easily repossess or recover it. The respondent proposed that administrators should be required to detail the location of the equipment in the notice and ensure that the equipment is available for collection at that location for a set time after service of the notice. Failure by the administrator to ensure the equipment is at the location when the owner or lessor seeks to recover it within the time frame would constitute use of the equipment and the notice would cease to have effect.

⁶³⁶ At 51-52.

⁶³⁷ ALRC 45, vol 1, paras 90-91.

⁶³⁸ s 443B(8).

⁶³⁹ The Law Reform Commission recommended that the court have this power: ALRC 45, vol 1, para 91. The Commission noted that the emphasis would remain on the administrator's duty to investigate, but the administrator could still be protected from genuinely unknown liability. The Explanatory Memorandum to the Corporate Law Reform Bill 1992 states (para 567) that the court may grant an exemption where "the books of the company were in such a disordered state that the administrator was unable, even using his or her best endeavours, to ascertain within 7 days whether the company had any assets".

⁶⁴⁰ Australian Finance Conference *Submission*.

6.65 The Legal Committee does not agree with this proposal. Such an obligation would place an undue burden on administrators. Owners and lessors can communicate directly with the administrator to arrange for repossession or recovery of the relevant property.

Limitations on the administrator's right of indemnity

6.66 One case has held that:

- an administrator's indemnity for debts incurred in the course of an administration does not cover a supplier's civil action for conversion against the administrator for selling materials supplied to the company by the supplier
- however, an administrator who, in good faith, sells property producing a fund has an equitable lien over that fund for the reasonable costs and expenses of resisting a claim for conversion and the cost of settling or meeting that claim.⁶⁴¹

6.67 This decision could limit an administrator's right of indemnity in other areas of tortious liability where there is no right of equitable lien. The Legal Committee in its Discussion Paper proposed that the administrator's right of indemnity should be extended to include 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.⁶⁴² The Legal Committee also considers that an administrator should not be liable for conversion for the sale of any property subject to a lien, pledge or reservation of title clause.⁶⁴³ The Law Reform Commission supported protecting administrators from personal liability for obligations properly incurred on behalf of their companies.⁶⁴⁴

6.68 Submissions that commented on this proposal unanimously supported it.⁶⁴⁵

6.69 One respondent qualified its support by saying that an administrator's right of indemnity should not cover liabilities that are or may be capable of being covered by insurance. The administrator should be obliged to effect appropriate insurance to

⁶⁴¹ *Commonwealth Bank of Australia v Butterell* (1994) 14 ACSR 343, 12 ACLC 727. Young J held that the administrator was not entitled to an indemnity under s 443D because a claim in conversion was not a liability for goods bought or property hired, leased, used or occupied within the meaning of s 443A. Compare *Molit (No 55) Pty Ltd v Lam Soon Australia Pty Ltd (administrator appointed)* (1996) 14 ACLC 1,371, in which Branson J held that an unliquidated claim for damages for failure to comply with a covenant in a lease to make good damage caused to leased premises (when the administrator caused the company to remove fittings from leased premises) was not a debt within the meaning of s 443A(1).

⁶⁴² Proposal 23.

⁶⁴³ Recommendation 23, *supra*.

⁶⁴⁴ ALRC 45, vol 1, para 86.

⁶⁴⁵ Allen Allen & Hemsley for QIDC *Submission*, Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

cover those liabilities, and then to have first recourse to that insurance. Failure to insure adequately should not be permitted to erode the assets available for distribution to the creditors.⁶⁴⁶ The Legal Committee does not agree. This requirement could in effect impose an open-ended obligation on administrators to take out insurance for every conceivable insurable event.

Recommendation 41. 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.

Deed administrator's ability to sell the company's shares

6.70 A deed administrator has the power to enter into and complete any contract for the sale of shares in the company.⁶⁴⁷ The administrator may use this power to issue new shares, for instance to raise capital,⁶⁴⁸ or to sell forfeited shares.⁶⁴⁹ However, there is a doubt whether a deed administrator has the power to sell existing shares in the company without the consent of their holders (compulsory sale power).

6.71 Arguments supporting the deed administrator having a compulsory sale power are:⁶⁵⁰

- the deed is taken to include the prescribed provisions (including the power to contract for the sale of shares in the company) unless the deed provides otherwise⁶⁵¹
- the deed binds the company's members,⁶⁵² and
- the incidental powers are sufficiently wide to give the administrator the power necessary to fulfil the purposes of the deed.⁶⁵³

6.72 Arguments against deed administrators having a compulsory sale power are:⁶⁵⁴

- the existing shares of a company are the property of the members
- other insolvency administrators such as liquidators and receivers do not have a comparable power.

In one case that considered this matter, the Federal Court held that a deed administrator had no power to sell members' shares in the company without their consent.⁶⁵⁵

⁶⁴⁶ Westpac *Submission*.

⁶⁴⁷ Corp Reg 5.3A.06, Schedule 8A, cl 2(zc).

⁶⁴⁸ J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,596-11,599.

⁶⁴⁹ Ernst & Young *Submission*.

⁶⁵⁰ GJ Hamilton, "Deeds of Company Arrangement: The Prescribed Provisions" (1995) 3 *Insolvency Law Journal* 67 at 75-76.

⁶⁵¹ s 444A(5).

⁶⁵² s 444G(b).

⁶⁵³ Corp Reg 5.3A.06, Schedule 8A, cl 2(zf), (zg).

⁶⁵⁴ GJ Hamilton, "Deeds of Company Arrangement: The Prescribed Provisions" (1995) 3 *Insolvency Law Journal* 67 at 76.

⁶⁵⁵ *Mulvaney v Wintulich* (Federal Court, 29 September 1995).

6.73 The Legal Committee in its Discussion Paper considered⁶⁵⁶ whether the Corporations Law should give deed administrators a compulsory sale power if:

- the share sale is for the purpose of implementing a deed of company arrangement which has been accepted by the creditors, and
- creditors will not receive full payment of their debts unless the shares are sold. For instance, a deed may be based on an investor acquiring all or a minimum proportion of the existing shares in a company in return for the payment of a lump sum for the benefit of creditors.

6.74 The forced sale of existing shares may enable the administrator to “clean up” the balance sheet of a listed holding company, thereby enabling trading in its shares to resume.⁶⁵⁷

6.75 However, the Legal Committee recognised the possibility that giving deed administrators this power of forced sale could be abused by opportunistic creditors who acquire those shares, especially as the test of insolvency⁶⁵⁸ is based on cash flow, rather than total assets and liabilities. For instance, a deed that involves creditors swapping their debt for equity in the company may unfairly advantage the creditors where the company has a strong underlying business.

6.76 The Legal Committee therefore proposed that a deed administrator should only have the power to sell a company’s shares, either with the prior consent of their holders or, in the absence of that consent, with the leave of the court.⁶⁵⁹ Also, any member or creditor of a company under administration, or the Commission, should have standing to oppose a court application to sell these shares without consent, for instance on the grounds that the sale price was less than market value.

6.77 Submissions generally supported this proposal.⁶⁶⁰

6.78 Two submissions suggested that deed administrators should have the power to sell existing shares compulsorily when a deed of company arrangement will not result in any return to the shareholders of the company.⁶⁶¹ The Legal Committee does not agree. Administrators should have no power to deal in existing shares without the

⁶⁵⁶ At 54-55.

⁶⁵⁷ J O’Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,596.

⁶⁵⁸ s 95A.

⁶⁵⁹ Proposal 24.

⁶⁶⁰ Australian Bankers’ Association *Submission*, Australian Credit Forum *Submission* (though this organisation was unable to obtain a consensus of its membership), Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

⁶⁶¹ Horwath *Submission*, VALRC *Submission*. Similarly, J O’Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,598 considers that administrators should be permitted to sell members’ shares without their consent, on the basis that the shares are worth little, if anything, to the members but may be worth something to a prospective purchaser of the assets and undertaking of the company. This, in turn, could produce a better return to creditors than would otherwise be available.

consent of their holders or the court, even when, under a deed of company arrangement, the shares have no value. Rather, an administrator in a court application could point to that fact as justification for a compulsory sale.

6.79 One respondent also questioned why anyone other than the members of the company should have standing to oppose an application for leave.⁶⁶² The Legal Committee considers that it is appropriate for the Commission to have standing to permit it to act in the public interest where necessary. Also, creditors may have an interest in opposing a forced share sale that transfers control of a company. That share transfer could affect the company's performance while the deed is in force (for instance, by a change of directors through shareholder resolution).

6.80 The Legal Committee in its Discussion Paper also invited submissions on whether there should be any controls over the price for any sale of the company's shares.⁶⁶³ Only two respondents favoured controls.⁶⁶⁴ One said that the shares should be sold for not less than their market value. If there is no market, they should be sold for not less than their value, having regard to generally accepted valuation methods including the net asset value of the shares.⁶⁶⁵

6.81 Submissions generally opposed any control over the sale price of the shares,⁶⁶⁶ for the following reasons.

- There is currently no restriction on the sale price of other assets sold by administrators, and shares are less likely than real assets to have any value.⁶⁶⁷
- The only relevant issue is whether the deed administrator has obtained the best price reasonably obtainable for the company's enterprise in all of the circumstances, whether the price is for a sale of the company's shares or a sale of its assets.⁶⁶⁸

6.82 The Legal Committee does not consider that there should be any controls over the sale price of shares sold by the deed administrator.

Recommendation 42. Deed administrators should only have a power to sell existing shares in the company either with the prior approval of the holder of those shares or with the leave of the court. Members, creditors and the Commission should have standing to oppose a court application for leave.

⁶⁶² Richard Fisher *Submission*.

⁶⁶³ Issue 3.

⁶⁶⁴ Ernst & Young *Submission*, Westpac *Submission*. The Westpac *Submission* did not suggest particular controls, but considered that creditors at least, and perhaps also the court, should consent to the sale price.

⁶⁶⁵ Ernst & Young *Submission*.

⁶⁶⁶ Australian Bankers' Association *Submission* (which said that any provision in relation to sale price should be related to winding up value), Australian Credit Forum *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁶⁶⁷ Geoff McDonald *Submission*.

⁶⁶⁸ Richard Fisher *Submission*.

Power to sell the assets of a company

6.83 An administrator and a deed administrator have the power to sell property of the company.⁶⁶⁹ However, the duty of care owed by the administrator and deed administrator in exercising this power is not specified. By contrast, receivers and managers “must take all reasonable care to sell the property for:

- (a) if, when it is sold, it has a market value - not less than that market value; or
- (b) otherwise - the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold”.⁶⁷⁰

6.84 The Legal Committee in its Discussion Paper recognised that administrators and deed administrators have a general duty of care as officers of the company.⁶⁷¹ However, the Committee considered that they should be subject to a specific duty to sell on terms advantageous to the creditors of the company as a whole (rather than at market value or the best available price).⁶⁷² For instance, a company may sell its book debts to a creditor for less than it might otherwise obtain. However, in return, the creditor may release the company from debts owed to the creditor. The overall effect may be to the advantage of the company and its creditors.

6.85 Some submissions supported this proposal.⁶⁷³

6.86 Other submissions opposed the proposal⁶⁷⁴ for the following reasons.

- The courts should decide these matters on the merits of each case.⁶⁷⁵
- It would be difficult to define “terms advantageous to the creditors”.⁶⁷⁶
- The Legal Committee’s proposal appears to have evolved from the increased statutory obligations imposed on receivers and managers

⁶⁶⁹ s 437A (administrator), Corp Reg 5.3A.06, Schedule 8A, cl 2(s), (za) (deed administrator).

⁶⁷⁰ s 420A. This provision applies to “controllers” of property. “Controller”, in relation to property of a corporation, means a receiver, or receiver and manager, of that property, or anyone else who (whether or not as agent for the corporation) is in possession, or has control, of that property for the purpose of enforcing a charge (s 9 definition of “controller”). This probably does not include administrators. Though administrators may be appointed by chargees over all or substantially all the property of a company (s 436C), “their main function is not to ‘enforce a charge’ but to examine the company’s affairs and make a determination about the future of that company”: C Hammond, “The Effect of Voluntary Administration Upon Property Rights: Harmony or Discord?” (1995) *Australian Property Law Journal* 9 at 21-22.

⁶⁷¹ At 70. An officer must exercise the degree of care and diligence that a reasonable person would: s 232(4). The definition of ‘officer’ includes administrators and deed administrators: s 232(1)(c), (ca).

⁶⁷² Proposal 32.

⁶⁷³ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, Ernst & Young *Submission* (subject to the reservation noted in the second dot point in para 6.87, post), Robert MH Cole & Co *Submission*.

⁶⁷⁴ Horwath *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁶⁷⁵ Horwath *Submission*, Geoff McDonald *Submission*, VALRC *Submission*. VALRC expressly supported the common law position under which administrators and deed administrators should seek to maximise the realisable value of assets for the benefit of creditors, in the context of the circumstances pertaining in any particular case.

⁶⁷⁶ Geoff McDonald *Submission*.

regarding the sale of property.⁶⁷⁷ An administrator (who acts in the interests of the creditors as a whole) is different from a receiver (who acts primarily in the interests of the appointor).⁶⁷⁸

6.87 Some submissions expressed reservations about the proposal.

- Maximisation of the estimated realisable value of assets may not always be possible due to the interests of, or claims by, secured creditors. An examination of all reasonable market opportunities may not be possible in the time available in an administration.⁶⁷⁹
- The proposal would disadvantage secured creditors unless those creditors have the right to refuse consent to a sale of assets subject to their securities. The interests of classes of creditors, including a class of creditors having an interest in the property being sold, should be considered.⁶⁸⁰

6.88 The Legal Committee no longer supports this proposal. The Committee is concerned that the proposal, by referring to a sale “on terms advantageous to the creditors of the company as a whole”, could create a specific duty to creditors which could give them an advantage over shareholders. For instance, an administrator might sell assets at a gross undervalue which nevertheless suffices to pay the creditors, leaving little or no residual funds for the shareholders. The Legal Committee notes that administrators are subject to the general duty of care and diligence.⁶⁸¹

Receipts and payments on the public record

6.89 A recent ASC Research Paper noted that it is not mandatory for the accounts of receipts and payments by administrators to be lodged with the Commission.⁶⁸² This contrasts with other forms of insolvency administration.⁶⁸³ The Research Paper considered that there was a strong argument for these accounts, especially those of deed administrators, to be on the public record.

6.90 The Legal Committee agrees.

Recommendation 43. Administrators and deed administrators should be required to lodge with the Commission accounts of receipts and payments.

Notifying creditors that an administration has ended

⁶⁷⁷ s 420A.

⁶⁷⁸ VALRC *Submission*.

⁶⁷⁹ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

⁶⁸⁰ Australian Bankers’ Association *Submission*, Ernst & Young *Submission*, Robert MH Cole & Co *Submission*, Westpac *Submission*.

⁶⁸¹ s 232(4).

⁶⁸² ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 1.215, 7.507. The prescribed provisions contain a requirement for deed administrators to lodge accounts (Corp Reg 5.3A.06, Schedule 8A, cl 10), but this requirement can be, and is being, deleted (s 444A(5)).

⁶⁸³ For instance, ss 432 (controllers), 539 (liquidators).

6.91 One respondent proposed that the administrator or deed administrator be required to notify creditors (by circular or advertisement) that the voluntary administration process, or any subsequent deed, has been finalised.⁶⁸⁴

6.92 The Legal Committee does not agree. The requirement would be superfluous as the creditors who attend the major meeting would be aware of its outcome. Also, creditors will already have been paid out under any subsequent deed of company arrangement.

Review of the qualifications and conduct of administrators and deed administrators

6.93 All administrators and deed administrators must be registered liquidators.⁶⁸⁵ One respondent⁶⁸⁶ proposed a review of the qualification requirements and complaints handling process for these persons. It favoured a self-governing regulatory body.

6.94 The Legal Committee notes that the recent *Report of the Working Party on the Review of the Regulation of Corporate Insolvency Practitioners* (June 1997) has canvassed these matters.⁶⁸⁷

⁶⁸⁴ VALRC *Submission*.

⁶⁸⁵ s 448B.

⁶⁸⁶ VALRC *Submission*.

⁶⁸⁷ For instance, paras 1.13-1.17, 1.19-1.21, 1.23, 6.18-6.124, 7.15-7.37, 7.52-7.56, Chapter 8.

Chapter 7. Winding up proceedings prior to an administration

This Chapter discusses limitations on the right of a company to appoint an administrator after the commencement of winding up proceedings, the power of a liquidator or provisional liquidator to appoint or apply for the replacement of an administrator and the right of a deed administrator to apply to the court to terminate a winding up. It also examines the right of creditors to apply to the court to appoint an administrator rather than make a winding up order.

Outstanding winding up application

7.1 A company that is subject to a winding up application that has not been determined by the court may nevertheless appoint an administrator.⁶⁸⁸ The effect of that appointment is that the court must adjourn its consideration of the application if 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.⁶⁸⁹

7.2 A recent ASC Research Paper on voluntary administration noted that the effect of appointing an administrator to a company in relation to which there is an outstanding winding up application would be to frustrate applicant creditors, and result in:

- the relation-back day being the date of the administrator's appointment rather than the earlier date of the filing of the winding up application
- applicant creditors' costs not being entitled to the priority to which they would have been entitled if the court had ordered the company's winding up⁶⁹⁰
- the company having a liquidator of its own choosing (by virtue of the administrator subsequently becoming the liquidator) rather than one appointed by the court.⁶⁹¹

7.3 The ASC Research Paper and some respondents to the Discussion Paper⁶⁹² suggested that the appointment of an administrator when there is an outstanding winding up application against the company should be prohibited, unless the court grants leave for the appointment of a voluntary administrator. The Research Paper suggested that any court leave could be granted at the hearing of the winding up application. The court-appointed liquidator could then decide whether to appoint an administrator. The Discussion Paper respondents suggested that the court could give the company leave to appoint an administrator.

⁶⁸⁸ s 436A (the company's general power to appoint an administrator). Note, however, the Legal Committee's recommendation that the company not have this power once a provisional liquidator has been appointed: Recommendation 45, post.

⁶⁸⁹ s 440A(2).

⁶⁹⁰ s 556(1)(b).

⁶⁹¹ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 7.505.

⁶⁹² Richard Fisher *Submission*, Geoff McDonald *Submission*.

7.4 The ASC Research Paper said that this restriction on the appointment of a voluntary administrator would have the following advantages:

- it would retain the earlier relation-back day
- it would allow an applicant creditor to pursue its claim and obtain the priority claim for its costs
- it would avoid the costs of the voluntary administration if the inevitable result is liquidation
- the court-appointed liquidator would be seen to be more independent than an administrator (who subsequently becomes the liquidator) appointed by the company.

7.5 The Research Paper acknowledged that the major disadvantages were:

- there may be a delay before the winding up application is heard by the court, whereas the administrator's appointment takes place immediately
- the company may have valuable contracts that may automatically terminate if a winding up order is made.

7.6 The Legal Committee does not support any prohibition on appointing an administrator when there is an outstanding winding up application against the company. A prohibition could:

- give the petitioning creditor, rather than the whole body of creditors, too much power
- defeat the policy underlying Part 5.3A of giving companies the opportunity to trade out of their current financial position.

Also, the current provision requiring the court to adjourn the hearing of an application for an order to wind up a company only if the court is satisfied that it is in the interests of that company's creditors for the company to continue under administration rather than be wound up⁶⁹³ is sufficient to prevent abuse.

7.7 In addition, the Legal Committee elsewhere recommends that the relation-back day in a winding up where an application has been made, and not dismissed, before the commencement of an administration should be the day on which the application for the winding up order was filed (regardless of whether the company is wound up by virtue of that application), not the date of the appointment of the administrator.⁶⁹⁴ This would resolve the relation-back problem raised in the ASC Research Paper.

Administration in lieu of a winding up application

7.8 One respondent⁶⁹⁵ suggested that individual creditors should be given the right to initiate a voluntary administration by applying to the court. The respondent pointed

⁶⁹³ s 440A(2).

⁶⁹⁴ Recommendation 52, post.

⁶⁹⁵ Geoff McDonald *Submission*.

out that creditors are currently limited to making an application for a winding up order. In many instances, the preferable course may be a voluntary administration.

7.9 The Legal Committee agrees that creditors should have this additional right. The requirement for court approval would ensure that the company is protected from frivolous appointments of an administrator. The right of a creditor to petition the court for winding up would remain.

Recommendation 44. The court should have the power, on application by a creditor of a company, to make an order appointing an administrator to that company.

Appointment of administrators to companies in provisional liquidation

Appointment by directors

7.10 The directors of a company that is being wound up cannot appoint an administrator.⁶⁹⁶

7.11 There is no equivalent express prohibition where a company is in provisional liquidation.⁶⁹⁷ On one view, the directors of such a company could not appoint an administrator, as only the provisional liquidator can exercise the powers of an officer of the company (including the power to appoint an administrator) while he or she is acting.⁶⁹⁸ However, one case has held that the company's directors can appoint an administrator, notwithstanding the prior appointment of a provisional liquidator.⁶⁹⁹

7.12 The Legal Committee proposed in its Discussion Paper that the Corporations Law should make clear that the directors of a company to which a provisional liquidator has been appointed cannot appoint an administrator.⁷⁰⁰ Submissions supported this proposal.⁷⁰¹

⁶⁹⁶ s 436A(2).

⁶⁹⁷ The winding up of a company that is not already being wound up, under administration or under a deed of company arrangement only begins when the court makes the winding up order: s 513A. The appointment of a provisional liquidator occurs before the making of a winding up order: s 472(2).

⁶⁹⁸ s 471A(2). The reference to "an administrator appointed for the purposes of an administration of the company beginning after the provisional liquidator was appointed" in s 471A(2)(b) could relate to an administrator appointed by the provisional liquidator under s 436B. In addition, s 440A(3) seems to regard voluntary administration and provisional liquidation as mutually exclusive. Any continuing power of the directors to appoint an administrator may also be considered to be inconsistent with the power of a liquidator and a provisional liquidator to appoint an administrator: s 436B.

⁶⁹⁹ *Object Design Inc v Object Design Australia Pty Ltd* (1997) 24 ACSR 678, 15 ACLC 1,356.

⁷⁰⁰ Proposal 2.

⁷⁰¹ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

Recommendation 45. The Corporations Law should explicitly provide that the directors of a company to which a liquidator or provisional liquidator has been appointed cannot appoint an administrator.

Appointment by chargees

7.13 A person who is entitled to enforce a charge over all or substantially all the property of a company cannot appoint an administrator where the company is being wound up.⁷⁰²

7.14 There is no equivalent express prohibition on a chargee appointing an administrator where a company is in provisional liquidation.⁷⁰³ In fact, it appears that chargees can appoint an administrator to a company in provisional liquidation.⁷⁰⁴

7.15 The Legal Committee in its Discussion Paper proposed that the Corporations Law should explicitly provide that a chargee over all or substantially all the property of a company to which a provisional liquidator has been appointed cannot appoint an administrator.⁷⁰⁵ This would result in similar restrictions for liquidations and provisional liquidations.

Submissions

7.16 Most submissions supported the effect of the proposal which would be to prohibit appointments of administrators by chargees in either circumstance.⁷⁰⁶ One of those submissions pointed out that a secured creditor can appoint a receiver or receiver and manager if it wants its own appointee.⁷⁰⁷

7.17 Those submissions that opposed the proposal (thus supporting the right of a chargee over all or substantially all the property of a company to appoint an administrator notwithstanding that the company is in provisional liquidation) gave the following reasons.⁷⁰⁸

⁷⁰² s 436C(2).

⁷⁰³ The winding up of a company that is not already being wound up, under administration or under a deed of company arrangement only begins when the court makes the winding up order: s 513A. The appointment of a provisional liquidator occurs before the making of a winding up order: s 472(2).

⁷⁰⁴ A person (other than a provisional liquidator, an administrator appointed after the appointment of the provisional liquidator, or a person acting with the approval of the provisional liquidator or the court) cannot exercise powers as an officer of a company while a provisional liquidator is acting: s 471A(2). However, neither a person entitled to enforce a charge nor a receiver and manager appointed by that person (s 471A(4)) is an officer of the company. The court in *Aloridge Pty Ltd (prov liq apptd) v Christianos* (1994) 13 ACSR 99, 12 ACLC 237 accepted that a chargee over all or substantially all the property of a company in provisional liquidation had the power to appoint an administrator under s 436C.

⁷⁰⁵ Proposal 2.

⁷⁰⁶ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

⁷⁰⁷ Robert MH Cole & Co *Submission*.

⁷⁰⁸ Ernst & Young *Submission*, Richard Fisher *Submission*, Westpac *Submission*.

- An administrator can attempt to restructure a company, whereas a liquidator's function is to wind the company up. There is no benefit in limiting the right of a secured creditor to opt for a voluntary administration rather than a winding up.
- Receivers appointed by secured creditors sometimes identify the possibility of rehabilitating a company. Chargeholders should have the choice of invoking the voluntary administration procedure for this purpose.⁷⁰⁹
- A chargee over any asset can appoint a receiver to that asset where a liquidator or provisional liquidator has been appointed. The receiver's main role is to realise the asset for the benefit of the appointor, not other creditors. By contrast, an administrator considers the interests of all creditors and the company itself.⁷¹⁰
- The secured creditor can better support a restructure of the company than a liquidator, who has no funds to support such a proposal if all the assets are subject to the secured creditor's charge (unless the secured creditor is prepared to support the liquidator).⁷¹¹

7.18 These reasons would also support a chargee being entitled to appoint an administrator to a company in liquidation.

Legal Committee response

7.19 The Legal Committee's proposal was intended to overcome a technical anomaly in the Corporations Law, whereby a chargeholder cannot appoint an administrator to a company in relation to which a winding up order has been made, but can appoint one where a winding up application, but not a winding up order, has been made and a provisional liquidator appointed. The proposal sought to introduce a uniform prohibition on chargees once a liquidator or provisional liquidator has been appointed.

7.20 The Legal Committee recognises that the Law Reform Commission recommended that a company be able to appoint an administrator "except where a company is in liquidation",⁷¹² but recommended no similar limitation on appointment by a chargeholder.⁷¹³ However, the Committee considers this limitation appropriate, whether the company is under the control of a liquidator or a provisional liquidator. Administrators and liquidators have similar control over the company's assets.

7.21 One of the submissions that favoured no limitation on appointment by chargeholders nevertheless recognised the possibility of conflict between an administrator and a liquidator.⁷¹⁴ The respondent therefore proposed that, if a chargeholder is permitted to appoint an administrator, notwithstanding that a company is in provisional liquidation:

⁷⁰⁹ Richard Fisher *Submission*.

⁷¹⁰ Westpac *Submission*.

⁷¹¹ Ernst & Young *Submission*.

⁷¹² ALRC 45, vol 1, para 63.

⁷¹³ ALRC 45, vol 1, para 66.

⁷¹⁴ Ernst & Young *Submission*.

- the administrator's powers up until the first meeting should be limited to the preservation of the assets subject to the charge
- similarly, the administrator's indemnity should be limited to assets subject to the charge
- at the first meeting, creditors should have the opportunity to replace the administrator with the liquidator. If this occurs, the administration would be deemed to end and the liquidation would continue. If the administrator is not removed, the administration would continue as if the liquidator had made the appointment under the current provisions.

7.22 However, the Committee does not support this approach. It notes that only chargees over all or substantially all the property of a company can appoint an administrator. The proposed limitation of the administrator's powers and indemnity is therefore not likely to be significant. Also, permitting creditors to replace the administrator with the liquidator would be a costly way to resolve the possible conflict of administrations. The Committee considers that the preferable way to avoid this conflict is to permit only the liquidator or provisional liquidator to appoint an administrator to a company in liquidation or provisional liquidation. Chargees should not have that power.

Recommendation 46. The Corporations Law should explicitly provide that a chargee over all or substantially all the property of a company to which a liquidator or provisional liquidator has been appointed cannot appoint an administrator.

Appointment of an administrator by a liquidator or provisional liquidator

Appointment of self with consent of creditors

7.23 A liquidator or provisional liquidator must obtain the leave of the court before appointing himself or herself as administrator.⁷¹⁵ The Legal Committee in its Discussion Paper proposed that such an appointment be permitted without the leave of the Court if supported by creditors,⁷¹⁶ for the following reasons.

- Part 5.3A is essentially a voluntary procedure (that is, one that need not involve the court).
- In practice, liquidators call creditors' meetings to discuss a company's affairs before appointing an administrator. It would be efficient to permit the creditors to approve a liquidator's appointment as administrator at such a meeting.

7.24 The Committee proposed that liquidators should continue to have the right to seek court approval for their appointment as administrators, in the absence of a formal resolution of creditors.

⁷¹⁵ s 436B(2).

⁷¹⁶ Proposal 3.

7.25 Submissions supported this proposal.⁷¹⁷ One of these respondents pointed out that a liquidator who applies to the court for leave to appoint himself or herself as an administrator would then have to call a meeting of creditors, who could remove that person as administrator.⁷¹⁸

7.26 Another submission said that it should be made clear that a liquidator who appoints himself or herself as administrator would be subject to the requirement to send creditors a statement of interest.⁷¹⁹ The Legal Committee agrees. That requirement should apply to all administrators, whatever the circumstances of their appointment.⁷²⁰

7.27 One submission gave qualified support for the proposal.⁷²¹ It considered that a liquidator should be required to seek, and be refused, the approval of the creditors before applying to the court for leave. The liquidator should then be obliged to demonstrate that his or her appointment would be preferable to the appointment of some other person or the adoption of some other course of action. The Legal Committee disagrees with this approach, given that it may unduly slow down the voluntary administration procedure.

Recommendation 47. A liquidator should be entitled to appoint himself or herself as administrator:

- with the approval of the creditors of the company, or
- with the leave of the court.

Appointment of persons connected with the liquidator or provisional liquidator

7.28 A liquidator or provisional liquidator of a company is apparently free to appoint his or her business partner, employer or employee as administrator without obtaining the leave of the court.⁷²² The Legal Committee in its Discussion Paper suggested that the rationale for regulating a liquidator's appointment as administrator, either by court approval or (as proposed) by consent of creditors, applies equally to these other persons.⁷²³ Submissions agreed.⁷²⁴

⁷¹⁷ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Major Airconditioning & Refrigeration Suppliers *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

⁷¹⁸ Geoff McDonald *Submission*.

⁷¹⁹ Richard Fisher *Submission*.

⁷²⁰ See Recommendation 36, *supra*.

⁷²¹ Westpac *Submission*.

⁷²² By contrast, the Law prohibits the appointment as administrator, without leave of the court, of a business partner or employee of an auditor of the company: s 448C(1)(f).

⁷²³ At 11-12, Proposal 4.

⁷²⁴ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

Recommendation 48. The leave of the court or the approval of creditors should be required for a liquidator or provisional liquidator to appoint his or her business partner, employee or employer as administrator of a company.

Stay and termination of a winding up

7.29 A liquidator or provisional liquidator of a company may appoint an administrator to that company.⁷²⁵ If the company executes a deed of company arrangement, an application to the court for a stay or termination of the winding up needs to be made. Currently, the liquidator, a creditor or a contributory of the company has standing to make this application.⁷²⁶ Deed administrators have no standing to make an application (though a deed administrator who is also the company's liquidator could apply in the latter capacity).

7.30 The Legal Committee in its Discussion Paper proposed that, once creditors have resolved to accept a deed, the deed administrator should also have the right to apply to the court for an order terminating a winding up.⁷²⁷ Submissions generally supported that proposal,⁷²⁸ though one respondent suggested that the deed administrator should obtain the prior approval of creditors.⁷²⁹ The Legal Committee maintains the position it adopted in the Discussion Paper. To require any creditor approval could inhibit the ability of the deed administrator to act expeditiously.

7.31 The Legal Committee in the Discussion Paper also proposed that, on any application, the court should be directed to grant the order unless it is satisfied that it would be unjust to do so. The court should be directed to have regard to:

- any misconduct of the company's officers reported by the administrator, the liquidator or the Commission, and
- the commercial decision of creditors in accepting the deed of company arrangement.

7.32 Submissions generally supported this proposal.⁷³⁰ However, one respondent did not support the proposed directions to the court regarding the termination of the winding up.⁷³¹ The specified matters would be considered by the court in any event and need not be codified. The Legal Committee agrees that it is inappropriate to limit the discretion of the court. However, it continues to see merit in specifying a non-exhaustive list of matters to which the court must have regard.

⁷²⁵ s 436B(1).

⁷²⁶ s 482.

⁷²⁷ Proposal 30.

⁷²⁸ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

⁷²⁹ Westpac *Submission*.

⁷³⁰ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, Westpac *Submission*.

⁷³¹ VALRC *Submission*.

7.33 Another respondent submitted that the directions to which it was proposed that the court should have regard did not take into account that courts currently do not permit insolvent companies to re-enter commercial life.⁷³² The Legal Committee agrees that it should be made clear that the court must consider whether the company would remain insolvent after the termination of a winding up following creditors' acceptance of a deed of company arrangement. For instance, the court should take into account any outstanding related party loans.⁷³³

7.34 A further respondent proposed that the court should have no role in staying or terminating a winding up where creditors have accepted a deed of company arrangement.⁷³⁴ In that situation, the creditors themselves should terminate the winding up by the following steps:

- filing a notice with the court and the Commission
- advertising the notice of termination in a newspaper.

The winding up would terminate after the expiry of a short period after the advertisement appears, say 10 business days.

7.35 The Legal Committee does not agree. It should be for the courts, not creditors, to control the termination of a court winding up.

Recommendation 49. A deed administrator should have the right to apply to the court for an order terminating a winding up. In determining that application, the court should be directed to have regard to:

- any misconduct of the company's officers reported by the administrator, the liquidator or the Commission
- the commercial decision of creditors in accepting the deed of company arrangement
- whether the deed of company arrangement would leave the company insolvent, and
- such other matters as the court thinks fit.

Right of a liquidator or provisional liquidator to apply for the replacement of an administrator

⁷³² Richard Fisher *Submission*. The VALRC *Submission* also expressed concern about deeds being terminated while the company remained insolvent due to the existence of outstanding related party debts. See also *Re Depsun Pty Ltd* (1994) 13 ACSR 644, 12 ACLC 482, *Deputy Commissioner of Taxation v Foodcorp Pty Ltd* (1994) 13 ACSR 796, 12 ACLC 508, which concerned liquidators becoming administrators.

⁷³³ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 1.214, 7.506 noted that deeds of company arrangement commonly provide that related party creditors (who often vote to adopt the deed) do not participate in any distributions to creditors and do not release their debts against the company. This may result in the company being insolvent at the completion of the deed. The insolvent company may then continue to trade and incur further debts. The Paper suggested that consideration be given to whether related party loans should be written off or capitalised in these circumstances.

⁷³⁴ Ernst & Young *Submission*.

7.36 The Commission, a creditor or a member of a company can apply to the court for an order replacing an administrator.⁷³⁵ The Legal Committee in its Discussion Paper proposed that this right should be extended to a liquidator or provisional liquidator who has put the company into administration.⁷³⁶ Liquidators and provisional liquidators may be in a good position to assess the performance of particular administrators.

7.37 Most submissions agreed with this proposal.⁷³⁷

7.38 Some submissions disagreed.⁷³⁸ One respondent said that the only real way that a company can have an administrator and a liquidator at the same time is if the liquidator appointed that administrator, in which case the liquidator should not have the right to apply for the replacement of that administrator.⁷³⁹ However, the Legal Committee considers that the mere fact that a liquidator has appointed a particular administrator does not mean that the liquidator will necessarily be satisfied with that person's subsequent conduct of the company's affairs.

7.39 The Legal Committee maintains the approach it proposed in the Discussion Paper.

Recommendation 50. In addition to the Commission, a creditor or a member of a company, a liquidator or provisional liquidator who has put the company into administration should have the right to apply to the court for replacement of an administrator.

⁷³⁵ The general provision permitting replacement of an administrator is s 449B. The right to apply to the court under that section is restricted to the Commission or a creditor of the company. The court also has a power to make such order as it thinks just where an administrator is acting in a manner that is prejudicial to some or all of the company's members or creditors: s 447E. Members, as well as the Commission and creditors, have the right to apply to the court under this section.

⁷³⁶ Proposal 37, J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,494.

⁷³⁷ Australian Credit Forum *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, VALRC *Submission*.

⁷³⁸ Australian Institute of Credit Management *Submission*, Geoff McDonald *Submission*.

⁷³⁹ Geoff McDonald *Submission*.

Chapter 8. Liquidation following an administration

This Chapter deals with technical anomalies involving the voidable transaction and relation-back provisions that currently arise where a company under administration goes into liquidation. It also discusses the disclosure of information concerning the company's financial affairs, the right of creditors to choose their own nominee as liquidator and whether post-deed creditors should have a priority in a winding up. In addition, it examines whether the separate creditors' voluntary winding up procedure should remain.

Voidable transactions

8.1 One commentary that appeared after the publication of the Discussion Paper has drawn attention to two possible problems in applying the voidable transaction provisions to voluntary administrations:

- some transactions are inappropriately excluded from the voidable transaction provisions
- some transactions are inappropriately covered by the voidable transaction provisions.⁷⁴⁰

Transactions inappropriately excluded from the voidable transaction provisions

8.2 The voidable transaction provisions do not apply to transactions effected during a voluntary administration that precedes a winding up. The excluded transactions include transactions under a deed of company arrangement that has not terminated when the company goes into winding up. This gap creates the opportunity for abuse, in particular, where directors who resume control of a company under a deed of company arrangement pay creditors whose debts they have personally guaranteed in preference to other creditors. If the deed fails and the company goes into liquidation, a liquidator cannot recover these preferential payments under the voidable transaction provisions, for the reasons set out below.

8.3 Currently, an insolvent transaction is voidable if it was entered into:

- (i) during the 6 months ending on the relation-back day,⁷⁴¹ or
- (ii) after that day but on or before the day when the winding up began.⁷⁴²

8.4 The problem is that the tests of what constitutes the “relation-back day” and “the day when the winding up began” differ, depending on whether or not a voluntary administration (including a deed of company arrangement) has preceded the winding up.

Where no voluntary administration precedes the winding up

⁷⁴⁰ P Crutchfield and L Johnson, *Voluntary Administrations*, Paper delivered to the BLEC Insolvency Masterclass, Melbourne 12-13 March 1998, Sydney 17-18 March 1998 at 11-12.

⁷⁴¹ s 588FE(2)(b)(i).

⁷⁴² s 588FE(2)(b)(ii).

8.5 In this case:

- the relation-back day is the day on which the application for a winding up order is filed,⁷⁴³ and
- the winding up begins on the day when the winding up order is made.⁷⁴⁴

8.6 In consequence, the voidable preference provisions apply to all transactions in the six month period prior to the date of the application for a winding up order (applying (i) above) and, in addition, to all transactions in the period between that application and the making of that order (applying (ii) above). The provision therefore works satisfactorily.

Where a voluntary administration precedes the winding up

8.7 In this case:

- the relation-back day is the day on which the voluntary administration began⁷⁴⁵
- the winding up begins on the day on which the voluntary administration began.⁷⁴⁶

8.8 In consequence, transactions in the six months prior to the day on which the voluntary administration began are subject to the voidable preference provisions (applying (i) above). However, transactions made after the beginning of the administration (including those made under any deed of company arrangement) are not subject to the voidable preference provisions, given that the test in (ii) only covers transactions on or before the day on which the voluntary administration began.⁷⁴⁷

Other voidable transaction provisions

8.9 The various specific time periods for uncommercial transactions, related party transactions, transactions for the purpose of defeating, delaying or interfering with the rights of creditors and unfair loans all end on the day on which the voluntary administration began.⁷⁴⁸ Thus none of these transactions will be voidable in a winding

⁷⁴³ paragraph (a) of the s 9 definition of “relation-back day”.

⁷⁴⁴ s 513A(e).

⁷⁴⁵ paragraph (b) of the s 9 definition of “relation-back day”, ss 513A(b), (c), (d), 513C.

⁷⁴⁶ ss 513A(b), (c), (d), 513C.

⁷⁴⁷ In addition, it is arguable that the transactions will not be void dispositions under s 468, as dispositions under a deed of company arrangement are exempt from that provision: s 468(2)(ab). The Legal Committee notes a contrary argument that s 468(2)(ab) would not have this effect, as it only applies to dividends paid by the deed administrator to deed creditors: P Crutchfield and L Johnson, *Voluntary Administrations*, Paper delivered to the BLEC Insolvency Masterclass, Melbourne 12-13 March 1998, Sydney 17-18 March 1998 at 11. These commentators also pointed out that s 468 only applies to court windings up, not creditors' voluntary windings up.

⁷⁴⁸ s 588FE(3), (4), (5) refer to the relation-back day, while s 588FE(6) refers to the day when the winding up began. In both instances, where a voluntary administration precedes the winding up, that day is the day on which the voluntary administration began.

up where they take place after the beginning of an administration that precedes a winding up.

Law reform: two possible approaches

8.10 The Legal Committee has considered two possible policy solutions to deal with preferences and other voidable transactions where a voluntary administration precedes a winding up.

8.11 *First Policy Option: Apply the voidable transaction provisions.* All transactions that take place during the course of a voluntary administration (including the administration of a deed) that precedes any form of court or voluntary winding up could be made subject to the voidable transaction provisions.⁷⁴⁹

8.12 However, this policy option would make it unnecessarily difficult for an administrator or deed administrator to carry on the business of the company while the company is under administration or under a deed. Creditors would be reluctant to deal with the company if payments made to them could be set aside should the company subsequently go into liquidation (notwithstanding that an administrator would be liable for debts owing to creditors).

8.13 This policy option might be restricted to payments by a company that has been returned to the control of its directors under a deed of company arrangement. However, this approach could require companies to adopt the more costly alternative of retaining an insolvency practitioner as deed administrator, to avoid the uncertainty that would flow from the possibility that payments to creditors might be recovered as preferences. The opposing argument is that a company that has been returned to the control of its directors should be treated in the same manner as any other fully operational company. If that company becomes insolvent while trading under a deed of company arrangement, it might be considered justifiable to apply the general insolvency rules, including the rules regarding preferences.

8.14 *Second Policy Option: Voidable transactions applicable only where directors benefit.* Any payment by a company under a deed of company arrangement that is being administered by the company's directors (though not payments by administrators and deed administrators) could be voidable where the directors would benefit directly or indirectly from the payment. However, it may be difficult to determine in particular cases whether a director has benefited directly or indirectly from a payment.

8.15 The Legal Committee favours the first policy option, with some modifications, as outlined at para 8.18 below.

Transactions inappropriately covered by the voidable transaction provisions

8.16 Where a company has entered into a deed of company arrangement, distributions are made under the deed, the deed is terminated and the company subsequently goes into administration, immediately followed by a winding up, the

⁷⁴⁹ Currently, s 451C protects payments and actions by an administrator from the preference provisions.

relation-back day is the date the second administration begins.⁷⁵⁰ Distributions under the deed could therefore be liable to challenge by a liquidator under the voidable transaction provisions.

8.17 This anomaly could be removed by having an exception to the voidable transaction provisions for “transactions that are specifically authorised by a deed of company arrangement and carried out by the administrator of that deed”.

Legal Committee view

8.18 The Legal Committee considers that the two problems with the voidable transaction provisions (namely, transactions inappropriately excluded and transactions inappropriately covered by these provisions) can best be rectified by providing that transactions that take place during the course of a voluntary administration (including during the administration of a deed) that precedes any form of court or voluntary winding up, other than:

- transactions performed by or with the authority of an administrator or a deed administrator (even if in fact performed by the directors)
- transactions that are specifically authorised by a deed of company arrangement and carried out by the administrator of that deed (who must be a registered liquidator⁷⁵¹)

should be subject to the voidable transaction provisions. Thus, transactions by company directors under a deed of company arrangement which are not authorised by the deed administrator would be subject to the voidable transaction provisions.

Recommendation 51. Transactions that take place during the course of a voluntary administration (including during the administration of a deed) that precedes any form of court or voluntary winding up, other than:

- transactions performed by or with the authority of an administrator or a deed administrator (even if in fact performed by the directors)
- transactions that are specifically authorised by a deed of company arrangement and carried out by the administrator of that deed

should be subject to the voidable transaction provisions.

⁷⁵⁰ ss 513A(b), 513B(b), 513C.

⁷⁵¹ s 448B.

Relation-back period

8.19 If a company goes into liquidation following the appointment of an administrator, the winding up is taken to have begun or commenced on the date of the appointment of the administrator.⁷⁵² The Legal Committee in its Discussion Paper noted a possible concern where an application to wind up a company has been on foot for a considerable period before the administrator's appointment.⁷⁵³ The Committee proposed that the relation-back day for a liquidation that arises from an administration should be the day on which the application for the winding up order was filed (regardless of whether the company is wound up by virtue of that application, but provided that the application has not been dismissed),⁷⁵⁴ for the following reasons:

- the relation-back period should be as long as possible to cover as many voidable transactions as possible
- directors can currently reduce the relation-back period by appointing an administrator some months after a winding up application is filed.

8.20 However, it should continue to be made clear that dispositions by the administrator do not constitute voidable dispositions.⁷⁵⁵ It would otherwise be difficult for an administrator to carry on the business of the company.

8.21 Submissions supported this proposal.⁷⁵⁶

Recommendation 52. Where:

- a company goes into liquidation after a voluntary administration
- an application for winding up has been made before the commencement of the administration, and
- the winding up application has not been dismissed

the relation-back day should be the day on which the application for the winding up order was filed (regardless of whether the company is wound up by virtue of that application), not the date of the appointment of the administrator. Dispositions by the administrator are not to constitute voidable dispositions.

⁷⁵² ss 513A, 513B, 513C.

⁷⁵³ At 68.

⁷⁵⁴ Proposal 31.

⁷⁵⁵ Recommendation 51, *supra*. A payment made, transaction entered into, or any other act or thing done, in good faith, by, or with the consent of, the administrator of a company under administration is currently not liable to be set aside in a winding up of the company: s 451C.

⁷⁵⁶ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*, Westpac *Submission*.

Report as to affairs on liquidation after administration

8.22 Currently there is no requirement for creditors to be given an updated report as to affairs if a company under administration proceeds into liquidation.⁷⁵⁷ These reports are important for liquidators, who must account to the Commission for the receipts and payments of funds throughout the liquidation by reference to the assets listed in that report.

8.23 The Legal Committee in its Discussion Paper proposed that the officer in control of a company immediately before its liquidation (be it the administrator, the deed administrator or the directors) should be required to lodge with the Commission a report as to affairs in the prescribed form within a set time after the deemed commencement of the liquidation, especially as the administrator or deed administrator may not become the liquidator.⁷⁵⁸

8.24 Some submissions supported this proposal.⁷⁵⁹ One of these submissions gave the additional reason that the accounts lodged by liquidators must be reconciled back to the report as to affairs.⁷⁶⁰

8.25 Others submissions disagreed.⁷⁶¹ The following alternative suggestions were made.

- The directors of the company should have the responsibility to submit a report as to affairs within a prescribed period after a winding up resolution or order.⁷⁶²
Legal Committee response. The administrator or deed administrator, rather than the directors, may have a better knowledge of the company's affairs at this stage.
- The administrator and deed administrator should be required to lodge regular accounts of receipts and payments.⁷⁶³
Legal Committee response. The Legal Committee elsewhere makes a recommendation to this effect.⁷⁶⁴ However, a report as to a company's affairs is not limited to these accounts.

⁷⁵⁷ The directors of a company that goes into creditors' voluntary winding up must present a report as to affairs, verified by all the directors, to the meeting of creditors: s 497(5)(a). The report must be made up to the latest practicable date before the notices of the meeting are sent. However, s 497 is taken to have been complied with in relation to a winding up that results from a voluntary administration: s 446A(3), Corp Reg 5.3A.07(3).

⁷⁵⁸ Proposal 35.

⁷⁵⁹ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, Geoff McDonald *Submission*, Westpac *Submission*. See also J O'Donovan, *Company Receivers and Administrators* (Law Book Company Limited, loose leaf service) at 11,481.

⁷⁶⁰ Geoff McDonald *Submission*.

⁷⁶¹ The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

⁷⁶² The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*. The Law Council of Australia *Submission* also favoured only directors being required to prepare reports as to affairs.

⁷⁶³ Horwath *Submission*. Cf the requirement for liquidators: s 539(1), Corp Regs Schedule 2 Form 524.

⁷⁶⁴ Recommendation 43, *supra*.

8.26 Two submissions were concerned to avoid duplication.⁷⁶⁵ One suggested limiting the requirement for an updated report to where the administrator does not become the liquidator.⁷⁶⁶ A liquidator who has been the administrator, having been in control of the company's affairs since the beginning of the administration, should know all financial information since the beginning of the administration. The cost of preparing a report as to affairs in these circumstances appears to outweigh any perceived benefits to creditors.

8.27 The other submission distinguished between a company that is under administration immediately before a liquidation and one that is subject to a deed of company arrangement.⁷⁶⁷ It suggested that:

- the proposed requirement should only apply where a company goes into liquidation after having been subject to a deed of company arrangement
- to avoid duplication, if the company proceeds into liquidation after administration, the report as to affairs lodged with the administrator could be lodged with the Commission, with the liquidator's comments.

8.28 The Legal Committee considers that the key to its original Discussion Paper proposal, and to the concerns raised in submissions, is for the person in control of a company immediately before the company goes into liquidation to update information for the benefit of:

- any new insolvency practitioner who is assuming control of the company's affairs
- creditors generally.

8.29 The principal document concerning the affairs of a company under administration is the report prepared by the administrator before the major meeting of creditors (the s 439A report).⁷⁶⁸ This report is sent to creditors, but is not lodged with the Commission, as it may contain commercially confidential information. However, at the liquidation stage, commercial confidentiality is no longer a concern.

8.30 The Legal Committee therefore considers that the officer in control of a company under administration, or under a deed of company arrangement, immediately before the company proceeds into liquidation should be required to lodge with the Commission, at the time the company goes into liquidation, the s 439A report and a further report on:

- any matters not referred to in the s 439A report, and/or
- any material changes to matters referred to in that report

which affect the financial position of the company and of which that person has become aware before the date of the further report.

⁷⁶⁵ Ernst & Young *Submission*, VALRC *Submission*.

⁷⁶⁶ VALRC *Submission*.

⁷⁶⁷ Ernst & Young *Submission*.

⁷⁶⁸ s 439A(4)(a).

8.31 The Committee considers it unnecessary to distinguish between a company under administration and one subject to a deed of company arrangement prior to liquidation. Instead, in either instance, the relevant officer should be obliged to lodge an updated report if there have been any material new matters or changes which affect the financial position of the company and of which that officer is aware. This updating requirement would overcome the duplication concern, given that there may be little or no additional information that needs to be included in any updated report where a company under administration proceeds to liquidation.

Recommendation 53. The officer in control of a company under administration, or under a deed of company arrangement, immediately before the company proceeds into liquidation should be required to lodge with the Commission, at the time the company goes into liquidation, the s 439A report and a further report on:

- any matters not referred to in the s 439A report, and/or
- any material changes to matters referred to in that report

which affect the financial position of the company and of which that person has become aware before the date of the further report.

Right of creditors to choose the liquidator

8.32 A company under administration may go into winding up if:

- the creditors resolve at the major meeting of creditors that the company be wound up,⁷⁶⁹ or
- the company fails to execute a deed within the requisite time.⁷⁷⁰

8.33 A company under a deed of company arrangement may go into winding up if:

- the creditors resolve to terminate the deed and wind the company up⁷⁷¹
- the court makes an order terminating the deed,⁷⁷² or
- the deed specifies circumstances in which the deed is to terminate and the company is to be wound up and those circumstances exist.⁷⁷³

8.34 In these situations, the administrator or the deed administrator, as the case may be, is taken to be the liquidator.⁷⁷⁴

8.35 The Legal Committee in its Discussion Paper proposed that:

- creditors should have the right to appoint their own nominee as liquidator,⁷⁷⁵ and

⁷⁶⁹ ss 446A(1)(a), 439C(c).

⁷⁷⁰ ss 446A(1)(b), 444B(2).

⁷⁷¹ ss 446A(1)(c), 445E.

⁷⁷² s 446B(1), Corp Reg 5.3A.07(1)(a), s 445D.

⁷⁷³ s 446B(1), Corp Reg 5.3A.07(1)(b).

⁷⁷⁴ s 446A(4), Corp Reg 5.3A.07(4).

⁷⁷⁵ The Law Reform Commission considered that creditors should have the right to choose their own appointee as liquidator: ALRC 45, vol 1, para 112.

- the administrator or deed administrator should become the liquidator if the creditors do not exercise this right.⁷⁷⁶

8.36 Some submissions opposed the proposal,⁷⁷⁷ for the following reasons.

- It could lead to substantial delays and costs while a new appointee becomes familiar with the company's affairs.⁷⁷⁸
- Creditors already have sufficient remedies to remove the liquidator (for instance, by application to the court), if the liquidator's conduct so warrants.⁷⁷⁹
- Creditors have the right to replace the administrator at the first meeting of creditors under the voluntary administration knowing that the administrator may become the liquidator.⁷⁸⁰

8.37 Other submissions supported the proposal.⁷⁸¹ One of these respondents pointed out that, while creditors have the opportunity to replace an administrator at the first meeting, they may not necessarily choose a person on the basis of their possible skills as a liquidator. Creditors should be given a further opportunity to vote on the identity of the liquidator if they resolve that the company should be wound up. By that time, they would have had an opportunity to assess the expertise of the administrator.⁷⁸²

8.38 The Legal Committee considers that the right of creditors to have an insolvency practitioner of their own choice as liquidator outweighs the contrary arguments.

Recommendation 54. Creditors should have the right to appoint their own nominee as liquidator when a company under administration goes into winding up. If creditors do not appoint their own nominee, the administrator or deed administrator should become the liquidator.

Priority of post-deed creditors in a winding up

⁷⁷⁶ Proposal 36.

⁷⁷⁷ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*.

⁷⁷⁸ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*. See also P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 63, 205. However, that commentator considered that this argument is not strong enough to deny the creditors the right to determine who should be the liquidator of the company.

⁷⁷⁹ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*.

⁷⁸⁰ Horwath *Submission*.

⁷⁸¹ Australian Credit Forum *Submission*, Ernst & Young *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*. See also R King, "Voluntary Administrations: Proposals For Change" in JPG Lessing & JF Corkery, *Corporate Insolvency Law* (The Taxation and Corporate Research Centre, 1995) 91 at 99, 105, J Gibbons & G Green, *Achieving a "fair and reasonable" outcome with voluntary administration*, Paper delivered to the IIR Corporate Insolvency Conference, Sydney 31 October 1996 at 19-20.

⁷⁸² VALRC *Submission*. See also P Crutchfield, *Corporate Voluntary Administration Law* (Second Edition, Law Book Company Limited, 1997) at 63, 205.

The Crawford House decision

8.39 In the *Crawford House* decision, the court held that debts incurred by a company while under a deed of company arrangement administered by the company's directors were not provable against that company (under s 553) in any subsequent liquidation.⁷⁸³ The post-deed creditors had no means of recovering their debts in that liquidation.

8.40 To overcome this decision, the Parliament amended the Corporations Law in 1997 to make admissible to proof under s 553 all debts or claims incurred by a company that is under a deed of company arrangement (whether administered by a deed administrator or by the company's directors) immediately before a court order or resolution that the company be wound up.⁷⁸⁴

8.41 The amendments did not deal with whether debts due to post-deed creditors should have priority in any subsequent liquidation. The Federal Treasurer requested the Legal Committee to consider:

- whether debts and claims incurred by a company under a deed of company arrangement should be given priority in a subsequent liquidation
- whether there should be any difference in this regard between debts incurred through a deed administrator and debts incurred otherwise
- if priority is granted, whether there is any need for safeguards to prevent abuse of the priority, and
- if priority is granted, where the debts should rank as compared to other priority debts.⁷⁸⁵

8.42 The Legal Committee in its Discussion Paper canvassed various matters relevant to a consideration of these issues.⁷⁸⁶

Considerations raised in the Discussion Paper

Should post-deed creditors have priority?

⁷⁸³ *Re Crawford House Press Pty Ltd* (1995) 17 ACSR 295, 13 ACLC 874. Under the applicable law at the time of that case, debts were admissible if they arose before the date on which the winding up was taken, because of Division 1A of Part 5.6, to have begun: s 553(1) and s 9 definitions of "relevant date" and "begin". Where creditors of a company subject to a deed of company arrangement obtained a court order for winding up or resolved to wind the company up, the winding up was taken to have begun on the day the administration commenced (ss 513A(d), 513B(c), (d), s 513C(b)), unless there was a pre-existing winding up order, in which case the winding up was taken to have begun on the date the earlier winding up commenced (s 513C(a)). Therefore, debts incurred after the commencement of the administration, including debts arising under a deed of company arrangement, were not admissible to proof.

⁷⁸⁴ s 553(1A). The relevant date for other purposes, particularly the computation of debts and claims, is the date on which the deed terminates: s 553(1B). The Corporations Law also protects decisions by liquidators to admit proofs of debt and claims before the amendments came into force by validating liquidators' actions that are consistent with the amendments, though taken before commencement of the amendments: s 1411.

⁷⁸⁵ Discussion Paper Issues 5-8.

⁷⁸⁶ At 63-65.

8.43 An argument in favour of granting post-deed creditors priority over other unsecured creditors is that it would promote the continuation of the company's business. Post-deed creditors would have an incentive to deal with the company, given that their debts would have priority in any subsequent liquidation over those incurred before execution of the deed of company arrangement.

8.44 Contrary arguments are that:

- all the unsecured creditors of a company should, in principle, be treated equally, with the categories of priority creditors being kept to a minimum
- pre-administration creditors may be less likely to vote in favour of a deed of company arrangement if their debts are to rank behind those of post-deed creditors
- post-deed creditors may overextend credit to the company, to the detriment of pre-administration creditors.

Should there be any difference in priority between debts incurred by a deed administrator and debts incurred otherwise?

8.45 If the justification for a priority is to encourage the continuation of a company's business, there may be little reason to distinguish between debts incurred by a deed administrator on behalf of a company and debts incurred by the directors on the company's behalf under a deed of company arrangement. A possible contrary view is that deed administrators may be more objective than company directors in their assessment of the company's needs and only incur debts where necessary.

Are safeguards necessary if any priority is granted?

8.46 One possible safeguard that may be necessary is a right for pre-administration creditors to apply to the court if it appears that any post-deed creditors who are related creditors of the company⁷⁸⁷ are obtaining an unfair advantage. An alternative approach, namely postponing the debts of related creditors to those of all other unsecured creditors, may be too harsh as it would, in effect, usually result in the related creditors receiving little or no payment, regardless of the circumstances.

Where should post-deed creditors rank if priority is granted?

8.47 Currently, the expenses of preserving, realising or getting in property of the company, or in carrying on the company's business, incurred by:

⁷⁸⁷ A related creditor could be defined as a "related entity" who is also a creditor of the company (cf s 600A(3)). A "related entity" is:

- a promoter of the company
- a director or member of the company or of a related body corporate
- a beneficiary under a trust of which the company is or has been a trustee
- a relative, or de facto spouse, of any of those persons
- a relative of a spouse, or of a de facto spouse, of any of those persons
- a related body corporate of the company
- a body corporate one of whose directors is also a director of the company
- a trustee of a trust under which another related entity is a beneficiary (s 9).

- a liquidator or provisional liquidator of the company
- an administrator of the company, even if the administration ended before the winding up began
- an administrator of a deed of company arrangement executed by the company, even if the deed terminated before the winding up began

have first priority in a winding up.⁷⁸⁸ This priority does not extend to the remuneration and certain other expenses of those persons.⁷⁸⁹

8.48 The questions raised in the Discussion Paper were:

- if the expenses incurred by the directors of a company under a deed of company arrangement are given priority in a winding up, should this rank equally with debts incurred by the deed administrator of a company under a deed of company arrangement and the other debts that have first priority?
- if not, what priority should these expenses have?

Summary of submissions

Should post-deed creditors have priority?

8.49 Many submissions opposed all debts and claims incurred by a company under a deed of company arrangement being given priority in a subsequent liquidation.⁷⁹⁰ Some of those submissions favoured permitting creditors voting on a deed of company arrangement to include a priority for post-deed creditors as a term of the deed in particular cases.⁷⁹¹

8.50 However, two submissions⁷⁹² considered it essential for meeting the general objectives of Part 5.3A that all post-deed creditors be given a priority. Otherwise, suppliers would not have the confidence to continue to trade with the company. The decline of a company's business would mean that there were fewer assets available for distribution to creditors on a liquidation. One of these submissions also argued that:

- schemes of arrangement often provide scheme administrators with a charge over the assets of the company to secure the payment of post-scheme debts, effectively giving them a priority, even though the relevant legislation does not provide for any priority

⁷⁸⁸ s 556(1)(a).

⁷⁸⁹ s 556(1)(a), (2), definition of “deferred expenses”. These expenses are nevertheless paid in priority to other unsecured debts: s 556(1)(de).

⁷⁹⁰ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, VALRC *Submission*, Westpac *Submission*.

⁷⁹¹ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*, VALRC *Submission*, Westpac *Submission*.

⁷⁹² KPMG *Submission*, Geoff McDonald *Submission*.

- relying on the deed provisions to deal with the priority of post-deed debts incurred under a deed would lead to creditor confusion and undermine creditor confidence in trading with a company under a deed of company arrangement, by effectively requiring suppliers and creditors to review the terms of the deed to determine whether to trade with the company.⁷⁹³

Should there be any difference in priority between debts incurred by a deed administrator and debts incurred otherwise?

8.51 Some submissions considered that there should be no difference between debts incurred by a deed administrator and debts incurred otherwise.⁷⁹⁴

8.52 Other submissions argued that there should be a priority for debts incurred through a deed administrator, but not for debts incurred otherwise.⁷⁹⁵ For instance, where directors resume control of a company operating under a deed of company arrangement, they may abuse the voluntary administration provisions by incurring significant debts to related party creditors under the deed. Also, deed administrators may be more prudent, objective and independent than directors in incurring debts.

8.53 One respondent considered that insolvency practitioners would be very reluctant to become deed administrators without this priority.⁷⁹⁶ It is sometimes necessary to have deed administrators, as the previous management may not be suitable, or have sufficient creditor confidence, to continue to operate the company pending the introduction of new investors and management.

8.54 Another respondent⁷⁹⁷ raised the following concerns if priority was not granted to debts incurred by the deed administrator.

- Creditors who deal with an insolvency professional could find that their debts are left unpaid in a subsequent winding up, a possibility that does not currently arise under insolvency law.
- This would erode the current commercial certainty for creditors dealing with a company under the control of an independent insolvency practitioner, with consequential erosion of creditor confidence in the voluntary administration procedure.

8.55 A further respondent considered that there should only be a difference in treatment if the pre-administration creditors so agree.⁷⁹⁸

Are safeguards necessary if any priority is granted?

⁷⁹³ KPMG *Submission*.

⁷⁹⁴ KPMG *Submission* (priority for both kinds), Geoff McDonald *Submission* (priority for both kinds), Law Council of Australia *Submission* (priority for neither kind).

⁷⁹⁵ The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, VALRC *Submission*.

⁷⁹⁶ Ernst & Young *Submission*.

⁷⁹⁷ VALRC *Submission*.

⁷⁹⁸ Westpac *Submission*.

8.56 One respondent⁷⁹⁹ submitted that there should be strict limits on the amount of priority debt to be incurred:

- in actual dollar amounts, or
- as a proportion of the assets of the company, or
- as a percentage of existing debt.

8.57 The respondent proposed that the limits should be determined by the pre-administration creditors or the court. Any excess would have to be approved in advance by those creditors in general meeting, and the administrator's personal liability should expressly extend to any unauthorised debts incurred.

8.58 Submissions did not suggest any other specific safeguards, though some respondents pointed out that particular deeds of company arrangement could include specific safeguards.⁸⁰⁰

Where should post-deed creditors rank if priority is granted?

8.59 One respondent considered that there should be no change in the current ranking.⁸⁰¹

Legal Committee view on whether post-deed creditors should have priority

8.60 The Legal Committee has carefully weighed all the competing arguments. For the reasons outlined below, it considers that, with one exception (see para 8.68 and Recommendation 55, post), creditors dealing with a company trading under a deed of company arrangement should not have any statutory priority, whether the deed is administered by the deed administrator or by the company's directors. In consequence, the issues of whether any safeguards are necessary and where the debts should rank, if priority is granted, are irrelevant.

8.61 The Legal Committee's reasons why post-deed creditors should not in general have any statutory priority are as follows.

- A person dealing with a company operating under a deed of company arrangement is put on enquiry about whether the company will have sufficient assets to meet its liabilities. By contrast, pre-administration creditors often receive no indication that the company is insolvent until it goes into administration. A priority which automatically displaced pre-administration creditors in favour of post-deed creditors would be inequitable.
- Any statutory priority for post-deed creditors is at the expense of the pre-administration creditors who must vote whether or not to accept a deed of company arrangement. The pre-administration creditors may be reluctant

⁷⁹⁹ Westpac *Submission*.

⁸⁰⁰ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*, VALRC *Submission*.

⁸⁰¹ Ernst & Young *Submission*.

to vote for a deed, given that their return may be diluted if the company subsequently goes into liquidation.⁸⁰²

- A company that needs to offer priority to post-deed creditors in any subsequent winding up as an incentive for those creditors to deal with the company should perhaps not enter into a deed of company arrangement in the first place.
- Post-deed creditors may overextend credit if they have a priority recourse against the company's assets.

8.62 The Legal Committee considers that pre-administration creditors should be entitled to confer a priority on post-deed creditors under particular deeds of company arrangement. Pre-administration creditors may consider it in their interests to encourage post-deed creditors to trade with the company. The pre-administration creditors could include safeguards in the deed, for instance, a ceiling on the permitted amount of priority debts. Some submissions supported creditors having a right to grant post-deed creditors priority under the deed.⁸⁰³ A similar choice applies with schemes of arrangement, whereby a priority may be granted to post-scheme creditors.

8.63 The Legal Committee notes the argument in submissions that to rely on the deed provisions to deal with the priority of post-deed creditors might lead to those creditors being confused about their priority rights. The Committee considers that creditors trading with a company under a deed of company arrangement would assume that they had no priority, unless they specifically knew to the contrary, for instance, by reviewing the terms of that deed.

Priority of post-deed creditors where deed administrator is personally liable

8.64 The Corporations Law s 556(1)(a) provides that in any liquidation, the “expenses ... properly incurred by a relevant authority [“relevant authority” covers deed administrators, but not directors] in preserving, realising or getting in property of the company or *in carrying on the company's business*” must be paid as a first priority over all other unsecured debts and claims.

8.65 The issue is whether this provision, in effect, gives post-deed creditors a statutory priority over pre-administration unsecured creditors where the deed is administered by a deed administrator. If so, this provision would seem to be inconsistent with the Legal Committee's recommendation that post-deed creditors, in general, should not have a statutory priority.

8.66 The Legal Committee notes an argument that this provision has only a limited application, namely to post-deed debts incurred by the deed administrator which attract personal liability for that person. In that instance, the priority afforded to those post-deed creditors can be justified as a means of offsetting the possible personal liability of deed administrators. Those persons may otherwise be unwilling to accept appointment to that office.

⁸⁰² M Chapple, “Voluntary Insolvency Administration: Some Reforms Part II” [1997] *Butterworths Corporation Law Bulletin* [103] expressed a similar view.

⁸⁰³ Australian Institute of Credit Management *Submission*, Law Council of Australia *Submission*, VALRC *Submission*, Westpac *Submission*.

8.67 However, where the deed administrator is not personally liable for debts incurred by the company (for instance, where the deed provides that the deed administrator is acting as the agent of the company), there is no similar argument for giving these post-deed creditors a statutory priority.

8.68 The Legal Committee therefore considers that the Corporations Law should be amended to state specifically that, in the context of a liquidation that has followed a deed of company arrangement, the priority afforded to debts owed to post-deed creditors under s 556(1)(a) should only apply where the deed administrator is personally liable for those debts. This recommendation does not cover liabilities of a deed administrator falling outside the terms of s 556(1)(a), for instance, a liability for negligence.⁸⁰⁴

Priority of administrators not affected

8.69 The above discussion of priorities deals with the deed administrator and post-deed creditors. The Legal Committee confirms that all debts incurred by administrators in the pre-deed period should continue to have their current priority. Even though administrators act as agents for the company,⁸⁰⁵ they are also personally liable for debts they incur as administrator.⁸⁰⁶ Administrators need the priority protection where they are personally liable.

Recommendation 55. Where a liquidation follows a deed of company arrangement, post-deed creditors should have no statutory priority, except where the deed administrator is personally liable for debts covered by s 556(1)(a).

Creditors voting at the major meeting should have the right to include in a deed of company arrangement any other form of priority for post-deed creditors.

The current priority rights for debts incurred by administrators should remain.

Abolition of separate creditors' voluntary winding up procedure

8.70 The voluntary administration provisions provide for a transition from voluntary administration to creditors' voluntary winding up where the creditors resolve that the company be wound up or the company fails to execute a deed of company arrangement within the stipulated time.⁸⁰⁷ The Legal Committee in its Discussion Paper considered that the continued existence of creditors' voluntary winding up as a separate form of insolvency administration was unnecessary and proposed its abolition.⁸⁰⁸ Instead, an insolvent company could be wound up either by the court⁸⁰⁹

⁸⁰⁴ Paragraph 556(1)(a) only refers to expenses "properly incurred" by the deed administrator.

⁸⁰⁵ s 437B.

⁸⁰⁶ s 443A.

⁸⁰⁷ s 446A.

⁸⁰⁸ Proposal 34.

⁸⁰⁹ Parts 5.4-5.4B.

or pursuant to a resolution of creditors in a voluntary administration.⁸¹⁰ (Solvent companies may be wound up by members or by the court.)

8.71 The Committee noted that the Law Reform Commission recommended that creditors' voluntary winding up should be abandoned.⁸¹¹ The Law Reform Commission considered that creditors' voluntary winding up provided no ordered administration between the time of calling the meeting of creditors and the appointment of a liquidator. Also, there was no independent information about the financial affairs and conduct of the business of the company at the meeting of creditors.⁸¹² In addition, the Legal Committee notes that abolition of this form of winding up would avoid a possible technical anomaly in the procedure for moving from an administration to a winding up.⁸¹³

8.72 Some submissions supported the proposal to abolish creditors' voluntary winding up.⁸¹⁴

8.73 Many disagreed,⁸¹⁵ for the following reasons.

- The primary purpose of voluntary administration is to provide an opportunity for companies to reorder their affairs with a view to continued trading. This process is not appropriate for companies which should be placed in immediate liquidation, for instance if they are hopelessly insolvent.⁸¹⁶

Legal Committee response. The stated legislative objectives of the voluntary administration provisions are to maximise "the chances of the company, or as much as possible of its business, continuing in existence" or, if that is not possible, to administer the company in a manner that "results in a better return for the company's creditors and members than would result from an immediate winding up of the company".⁸¹⁷ Therefore,

⁸¹⁰ ss 439C(c), 445E. The Legal Committee elsewhere recommends that where a voluntary administration results in a winding up, the creditors should have the right to appoint their own nominee as liquidator: Recommendation 54, *supra*.

⁸¹¹ ALRC 45, vol 1, para 57.

⁸¹² ALRC 45, vol 1, para 49.

⁸¹³ The creditors of a company under administration can vote that the company be wound up: s 439C(c). However, this provision can be interpreted as conflicting with s 490 where an application to wind up a company in insolvency has been filed in the court and remains pending. Section 490 provides that a company cannot resolve to be wound up voluntarily if an application for it to be wound up in insolvency has been filed, except with the leave of the court. In *Brown v Carpet Design Group Pty Ltd* (1994) 13 ACSR 621, 12 ACLC 448, Gummow J considered that s 490 had no place in the statutory mechanism providing for the transition from voluntary administration to winding up pursuant to a resolution of creditors. However, in *Re Van Fox Pty Ltd* (1994) 13 ACSR 825, Thomas J considered that s 490 did apply to windings up following on voluntary administrations.

⁸¹⁴ Australian Credit Forum *Submission*, Horwath *Submission*.

⁸¹⁵ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, David Kerr *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*.

⁸¹⁶ The Discussion Group *Submission*, IPAA Melbourne Forum *Submission*.

⁸¹⁷ s 435A.

winding up is as legitimate an outcome of voluntary administration as entering into a deed of company arrangement.

- Voluntary administration would be unnecessarily costly as the only means to wind up an insolvent company voluntarily.⁸¹⁸
Legal Committee response. The Legal Committee considers that, if correct, this is the most persuasive objection to its proposal. However, the Committee relies on a recent ASC Research Paper which concluded that, while the initial costs of a liquidation through the voluntary administration procedure may be greater than the costs of a liquidation through either the court or the creditors' voluntary procedures, it is debatable whether the ultimate cost of a liquidation under the voluntary administration provisions is materially higher.⁸¹⁹ Some of the costs incurred under the voluntary administration provisions are incurred before liquidation and relate to the investigation and the report to creditors. At least some of these costs (for instance, in conducting an investigation) are likely to be incurred during a court or creditors' voluntary liquidation.
- It is very expensive to apply for a court winding up.⁸²⁰
Legal Committee response. The alternative to creditors' voluntary winding up, if it were abolished, would be winding up either by the court or pursuant to a resolution of creditors in a voluntary administration.

⁸¹⁸ The Discussion Group *Submission*, Ernst & Young *Submission*, IPAA Melbourne Forum *Submission*, VALRC *Submission* (for instance, where companies are hopelessly insolvent or have no prospect of achieving an improved outcome for creditors under the voluntary administration process). David Kerr *Submission* stated that the "duties and responsibilities imposed on the administrator, have resulted in costs associated with the procedure being greater than anticipated".

⁸¹⁹ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 2.112, footnote 6. The Research Paper mentions typical costs of \$10,000 to \$15,000 using Part 5.3A as opposed to \$5,000 through the court or the creditors' voluntary liquidation procedures.

⁸²⁰ Robert MH Cole & Co *Submission*.

- Creditors' voluntary winding up remains relevant where a members' voluntary liquidation subsequently becomes insolvent.⁸²¹
Legal Committee response. There is already provision for a members' voluntary winding up to proceed to a winding up in insolvency or a voluntary administration where the company turns out to be insolvent.⁸²²
- If the proposal were adopted, the relation-back day could be affected to the detriment of creditors.⁸²³
Legal Committee response. This appears to be a technical problem which could be avoided by appropriate drafting.
- If creditors' voluntary winding up were to be abolished, it would be necessary to draw up a procedure for conducting and finalising the liquidation.⁸²⁴
Legal Committee response. The current provisions for transition from voluntary administration to winding up⁸²⁵ would need to be amended to permit the winding up to proceed, notwithstanding the abolition of the creditors' voluntary winding up procedure.
- The abolition of creditors' voluntary winding up could unfairly prejudice shareholders' rights, given that the approval of shareholders as well as creditors is required to place a company into creditors' voluntary winding up.⁸²⁶
Legal Committee response. The Legal Committee acknowledges that, under the current provisions, a special resolution of a company's shareholders is necessary to wind the company up voluntarily (under either a members' or creditors' voluntary winding up).⁸²⁷ The Legal Committee's proposal to abolish creditors' voluntary winding up would remove the role of shareholders in creditors' voluntary liquidations. However, given that a company must generally be, or be likely to become, insolvent before it can go into voluntary administration,⁸²⁸ the rights of creditors should prevail over those of shareholders.

⁸²¹ Australian Institute of Credit Management *Submission*, Ernst & Young *Submission*, Law Council of Australia *Submission*.

⁸²² s 496(1)(a), (b). The Legal Committee's proposal would effectively require the repeal of s 496(1)(c).

⁸²³ Australian Institute of Credit Management *Submission*.

⁸²⁴ Ernst & Young *Submission*.

⁸²⁵ Part 5.3A Div 12.

⁸²⁶ VALRC *Submission*. VALRC acknowledges that preservation of members' rights under creditors' voluntary liquidation may not be of practical relevance, given that the members' equity is presumed to have disappeared in an insolvency. VALRC also recognised the significantly reduced use of creditors' voluntary liquidation since the introduction of voluntary administration.

⁸²⁷ s 491.

⁸²⁸ ss 436A (appointment by directors), 436B (appointment by liquidator or provisional liquidator). The Legal Committee notes that insolvency is not a mandatory requirement where a chargee over all or substantially all the property of a company appoints an administrator (s 436C).

8.74 A recent ASC Research Paper noted⁸²⁹ the following advantages of using the voluntary administration provisions as one means of liquidation:

- the company's affairs are brought under the control of an insolvency practitioner virtually immediately
- information concerning the company's affairs is available earlier to creditors
- contracts held by the company may not be rendered "in default"
- secured creditors are restricted from exercising their rights.

8.75 The Paper also noted the following possible cost disadvantages:

- administrators, being required to look to saving the business, or as much of it as possible, even if liquidation is virtually certain, may act cautiously by expending a disproportionate amount of the company's resources primarily to limit their personal liability
- the cost of providing, and holding a meeting to consider, information required to be gathered and prepared for creditors during a voluntary administration is unnecessary where the only realistic outcome is liquidation.

8.76 However, the Legal Committee notes that the current creditors' voluntary winding up procedure provides for a meeting of creditors.⁸³⁰ Creditors should have a right to a forum at which they can obtain information about the affairs of the company.

8.77 The Legal Committee maintains the view it adopted in the Discussion Paper that the current creditors' voluntary winding up procedure is inappropriate. It notes two submissions that suggested a modified creditors' voluntary winding up procedure involving:

- directors directly appointing a liquidator
- shareholders having no say in the decision to wind the company up
- creditors having the right either to ratify the directors' appointment at their meeting or to appoint an alternative liquidator.⁸³¹

⁸²⁹ ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at para 2.112, footnote 6.

⁸³⁰ s 497.

⁸³¹ David Kerr *Submission*, Geoff McDonald *Submission*.

8.78 However, the Committee favours the use of voluntary administration as the route to an insolvent voluntary winding up.

Recommendation 56. Creditors' voluntary winding up should be abolished.

Chapter 9. Implications for takeovers and fundraising

This Chapter discusses whether there should be any exemptions from the takeover or fundraising provisions for share acquisitions or offers pursuant to a voluntary administration.

Takeovers

9.1 Currently, any acquisition of shares under a voluntary administration of a company that is subject to Chapter 6 of the Corporations Law is subject to the takeover provisions in that Chapter. This contrasts with an acquisition of shares under a scheme of arrangement, which is exempt from those provisions.⁸³²

9.2 The Legal Committee in its Discussion Paper sought submissions on whether:

- acquisitions under a voluntary administration should be exempt from the takeover provisions
- any problems have occurred as a result of the absence of this exemption.⁸³³

9.3 An argument for this exemption is that it would give administrators the flexibility to deal with the company's affairs in the most appropriate manner.

9.4 Arguments against this exemption are:

- an administrator could permit a transfer of shares that results in a change of control without all shareholders having an equal opportunity to participate in the benefits of that change of control
- a voluntary administration, unlike a scheme of arrangement, does not always involve court supervision.

9.5 A contrary argument is that any member who is aggrieved by a transfer of shares by an administrator can use the oppression remedy.⁸³⁴

9.6 Many submissions considered that acquisitions of shares should be exempt from the takeover provisions,⁸³⁵ for the following reasons.

- A company in voluntary administration must be insolvent, unlike a normal company in a takeover. Even if there is some net value available for shareholders, creditors are the primary stakeholders. The takeover provisions are aimed at protecting the interests of members. As the

⁸³² s 625.

⁸³³ At 79-80, Issue 9.

⁸³⁴ s 260.

⁸³⁵ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Ferrier Hodgson *Submission*, Richard Fisher *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

takeover provisions can be costly to comply with, it is in the interests of creditors that those provisions not apply.⁸³⁶

- There is a similar exemption for schemes of arrangement.⁸³⁷

9.7 One respondent, while supporting this exemption, considered that members who have been substantially prejudiced should have a right to apply to the court for the takeover provisions to apply. The court should be required to take into account the impact the application of the takeover provisions would have on the interests of creditors.⁸³⁸ The Legal Committee questions the workability of this suggestion, in particular what remedies a court could grant once an acquisition has taken place.

9.8 Other submissions opposed any exemption.⁸³⁹ One of these respondents considered that the protections of the takeover provisions (for instance, adequate information for purchasers) should be paramount.⁸⁴⁰ Another of these respondents pointed out that this exemption might encourage companies to use voluntary administration as a means of effecting a change in control without complying with the takeover requirements.⁸⁴¹

9.9 The Legal Committee considers that, notwithstanding submissions to the contrary, there should be no exemption from the takeover provisions for an acquisition of shares under a voluntary administration, as:

- most companies that use the voluntary administration provisions are exempt from the takeover provisions, given their relatively small size⁸⁴²
- the argument that a company in voluntary administration must be insolvent, unlike a normal company in a takeover, does not fully take into account that the test of insolvency is a cashflow test,⁸⁴³ rather than a total assets and liabilities test, and the shares may therefore still have an intrinsic underlying value for shareholders. The control premium issue may therefore still be relevant for these companies
- in appropriate circumstances, the Commission can modify the takeover provisions for larger companies,⁸⁴⁴ 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.

⁸³⁶ Ernst & Young *Submission*, Geoff McDonald *Submission*.

⁸³⁷ s 625. This is retained under the *Draft Legislative Provisions* released under the Corporate Law Economic Reform Program: s 10 cl 17, p 262 of the draft Bill.

⁸³⁸ Ernst & Young *Submission*.

⁸³⁹ Australian Bankers' Association *Submission*, Australian Credit Forum *Submission*, Westpac *Submission*.

⁸⁴⁰ Westpac *Submission*.

⁸⁴¹ Australian Bankers' Association *Submission*.

⁸⁴² Paragraph 619(1)(a) exempts companies with not more than 15 members from Chapter 6. Under the *Draft Legislative Provisions* released under the Corporate Law Economic Reform Program, the takeover provisions will not apply to unlisted companies with 50 or fewer members: s 5(1)(a)(ii), p 249 of the draft Bill.

⁸⁴³ s 95A.

⁸⁴⁴ ss 728, 730. The substance of these provisions is retained in the *Draft Legislative Provisions* released under the Corporate Law Economic Reform Program: s 71, pp 315-316 of the draft Bill.

Recommendation 57. There should be no exemption from the takeover provisions for an acquisition of shares pursuant to a voluntary administration.

Fundraising

9.10 Currently, an offer or invitation by a company to acquire its securities in connection with a scheme of arrangement, but not a voluntary administration, is exempt from the prospectus and secondary trading provisions in Part 7.12 Divisions 2 and 3A.⁸⁴⁵

9.11 The Legal Committee in its Discussion Paper sought submissions on whether:

- offers and invitations to acquire securities in connection with a voluntary administration should be exempt from the fundraising provisions, or
- any problems have occurred as a result of the absence of this exemption.⁸⁴⁶

9.12 The advantage of a company under administration being exempt from the fundraising provisions is that it would give an administrator the flexibility to issue the company's securities in a manner most beneficial to the company.

9.13 The disadvantage is that it may enable an administrator to offer the company's securities without giving the acquirer the type of information that would be contained in a prospectus.

9.14 Some submissions agreed that offers or invitations by a company of its securities during the course of its voluntary administration should be exempt from the fundraising provisions.⁸⁴⁷

9.15 One respondent argued that imposing the fundraising requirements would:

- add to the cost of the process
- duplicate work already done, and
- unduly extend the time involved in completing the deed of company arrangement.⁸⁴⁸

⁸⁴⁵ Corp Reg 7.12.02(b).

⁸⁴⁶ At 79-80, Issue 10.

⁸⁴⁷ Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ferrier Hodgson *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, VALRC *Submission*.

⁸⁴⁸ Ferrier Hodgson *Submission*.

9.16 Other submissions raised the following concerns about any exemption from the fundraising provisions.

- The purpose of these provisions is to protect the public from misleading or deceptive representations about investments.⁸⁴⁹
- A proposed “equity for debt” swap under a deed of company arrangement does not currently require the independent scrutiny of either the court or the Commission (apart from any post-registration vetting of a prospectus). Also, reports by administrators are not assessed as rigorously as an explanatory statement prepared for a scheme of arrangement (which is exempt from the fundraising provisions) would be,⁸⁵⁰ given the time constraints under which voluntary administrators necessarily operate.⁸⁵¹

9.17 Some submissions opposed any exemption.⁸⁵² One of these respondents, while recognising the need to minimise expense and time wastage, considered that:

- the rigour required by the fundraising provisions may be appropriate
- most of the information required to prepare a prospectus should already have been prepared by the administrator.⁸⁵³

9.18 Another respondent⁸⁵⁴ suggested several alternatives for dealing with offers or invitations by a company under administration to acquire its securities:

- the current minimum threshold of \$500,000 could be lowered
- an offer could be exempt where the shareholding on offer exceeds 70% of the shares or voting power of the corporation in question.

9.19 That respondent also distinguished two situations:

- where the sale or issue is by the administrator or the deed administrator, and
- where the sale or issue is by a company operating under a deed of company arrangement that has been returned to the control of its directors.

9.20 The respondent suggested that an exemption could apply in the first, but not the second, situation, because of the professional duties owed by an administrator. This approach would balance the objective of protecting the public with the objective of providing the flexibility to allow the company to be restructured or realise its assets.

9.21 The Legal Committee considers that there should be an exemption from the fundraising provisions for offers or invitations to creditors to exchange debt for equity

⁸⁴⁹ Ernst & Young *Submission*.

⁸⁵⁰ s 412.

⁸⁵¹ Richard Fisher *Submission*. See *Deputy Commissioner of Taxation (Cth) v Comcorp Australia Ltd* (1996) 21 ACSR 590, 14 ACLC 1,616.

⁸⁵² Australian Bankers' Association *Submission*, Australian Credit Forum *Submission*, Richard Fisher *Submission*, Westpac *Submission*.

⁸⁵³ Australian Bankers' Association *Submission*.

⁸⁵⁴ Ernst & Young *Submission*.

under a deed of company arrangement. Those creditors are given information in the administrator's report.⁸⁵⁵ 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 that creditors receive in an administrator's report is not necessarily equivalent to that which would be found in a prospectus.

Recommendation 58. There should be an exemption from the fundraising provisions for offers or invitations to creditors to exchange debt for equity under a deed of company arrangement.

⁸⁵⁵ s 439A(4)(a).

Chapter 10. Other matters

This Chapter covers various miscellaneous matters relevant to voluntary administrations.

Objectives of Part 5.3A

10.1 The voluntary administration provisions 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 members than would result from an immediate winding up of the company.⁸⁵⁶

10.2 One respondent⁸⁵⁷ suggested that the legislation should include a third objective, namely to ensure maximum return to creditors.

10.3 The Legal Committee does not consider that this change is necessary. This principle is implicit in the two current stipulated objectives.

Expression of time periods

10.4 Part 5.3A of the Corporations Law uses two different types of terminology for establishing periods or dates in the course of an administration, namely “business days” and “days”. The Legal Committee, in its Discussion Paper, proposed that the terminology “business days” should be used throughout Part 5.3A.⁸⁵⁸ All submissions supported this proposal.⁸⁵⁹

10.5 However, one commentator has argued that the notion of “business day” can create complexities, given that the Australian States and Territories have some different public holidays.⁸⁶⁰ The Legal Committee considers that business days should be determined according to where the relevant creditors’ meeting is to occur, not, for

⁸⁵⁶ s 435A.

⁸⁵⁷ Ernst & Young *Submission*.

⁸⁵⁸ Proposal 1. This proposal would require changes to ss 438B(2), 443B(2), (3) (“5 business days” instead of “7 days”), 439A(5)(a) (“20 business days” instead of “28 days”), 439A(5)(b), 444B(2)(a), (b) (“15 business days” instead of “21 days”). This proposal would also have the consequence that the convening period provision (s 439A(5)) would not have to provide separately for the Christmas and Easter periods, given that public holidays are not “business days”: definition of “business day” in s 9.

⁸⁵⁹ Australian Credit Forum *Submission*, Australian Institute of Credit Management *Submission*, The Discussion Group *Submission*, Ernst & Young *Submission*, Horwath *Submission*, IPAA Melbourne Forum *Submission*, Law Council of Australia *Submission*, Geoff McDonald *Submission*, Robert MH Cole & Co *Submission*, VALRC *Submission*, Westpac *Submission*.

⁸⁶⁰ MD Chapple, “Voluntary Insolvency Administration: Some Reforms Part I” [1997] *Butterworths Corporation Law Bulletin* [91].

instance, where any advertisement of that meeting is published. Some consequential amendments may be necessary to make this clear.⁸⁶¹

Recommendation 59. All references to days in Part 5.3A should be to “business days”.

Disclosure of a change to a company’s name

10.6 A recent ASC Research Paper on voluntary administration noted that companies commonly change their name, often to their Australian Company Number (ACN) only, before appointing an administrator, to minimise the potentially damaging commercial effect of having their prior name associated with a voluntary administration.⁸⁶² This practice may disadvantage creditors who may not associate the new name with the company with which they have been dealing. For instance, creditors may not recognise the new name in notices of creditors’ meetings, in notices calling for proofs of debt and in general correspondence. The Research Paper acknowledged that this problem is not peculiar to voluntary administrations, but argued that these name changes may be frequent for companies that wish to use Part 5.3A.

10.7 The Research Paper proposed requiring a company to disclose its former name adjacent to its new name for 6 months after the change of name.

10.8 The Legal Committee supports the concept of requiring a company that changes its name within 6 months of a voluntary administration to disclose its previous, as well as its current, name on public documents.

Recommendation 60. Any company that changes its name during the course of, or in the 6 months before, a voluntary administration should be required to disclose its former, as well as its current, name on its public documents for the period of that administration or any subsequent liquidation.

Temporal restriction on the court’s general power

10.9 One respondent⁸⁶³ suggested that the court’s general power⁸⁶⁴ should only be exercisable during the course of an administration or whilst a company is under a deed of company arrangement.

10.10 The Legal Committee does not agree. An application for the court to exercise that power would usually be made within the periods suggested. However, the courts

⁸⁶¹ See, for instance, the problems raised by MD Chapple, id at footnote 5.

⁸⁶² ASC Research Paper 98/01 *A Study of Voluntary Administrations in New South Wales* at paras 1.216, 7.508.

⁸⁶³ Richard Fisher *Submission*.

⁸⁶⁴ s 447A.

can be left to decide whether there are any adequate grounds to grant an application made outside that time.⁸⁶⁵

Retentions held within the building industry

10.11 One respondent⁸⁶⁶ suggested that retentions held within the building industry could be deemed to be outside a company's assets when it goes into voluntary administration. Claims on retentions would otherwise rank as unsecured.

10.12 The Legal Committee does not agree. This matter is adequately covered by the general law.⁸⁶⁷

Stamp duty

10.13 Deeds of company arrangement are currently subject to stamp duty. By contrast, deeds of assignment and arrangement under Part X of the Bankruptcy Act are currently exempt from stamp duty.⁸⁶⁸

10.14 Exemption of deeds of company arrangement from stamp duty was part of the Law Reform Commission proposals.⁸⁶⁹ The imposition of stamp duty on these deeds could interfere with attempts to devise appropriate methods for rearranging the affairs of insolvent companies.

10.15 One respondent considered that deeds of company arrangement should not be subject to stamp duty.⁸⁷⁰

10.16 The Legal Committee considers that it may be appropriate for the relevant Governments to review whether their stamp duty laws should continue to apply to deeds of company arrangement.

⁸⁶⁵ Cf the decisions of Santow J confirming the court's power under s 447A to make retrospective orders: *Brien v Australasian Memory Pty Ltd* (1997) 25 ACSR 1, 15 ACLC 1,359, *Re Ricon Constructions Pty Ltd (in liq)* (1997) 26 ACSR 655, (1998) 16 ACLC 76.

⁸⁶⁶ Major Airconditioning & Refrigeration Suppliers *Submission*.

⁸⁶⁷ For instance, *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.

⁸⁶⁸ Bankruptcy Act s 227.

⁸⁶⁹ ALRC 45, vol 1, para 119.

⁸⁷⁰ Geoff McDonald *Submission*.

Appendix 1

List of Recommendations

The first and major meetings of creditors

Recommendation 1. The first meeting of creditors should be retained.

Recommendation 2. The time for holding the first meeting should be increased to 8 business days after the beginning of the administration, with 5 business days' notice of the meeting to creditors.

Recommendation 3. There should be a specific provision stating that creditors may only remove an administrator and appoint a replacement administrator through a single resolution.

The prospective replacement administrator should table at the first meeting, prior to any resolution:

- a written consent to act, and
- a statement of interest.

Recommendation 4. The directors' statement about the company's business, property, affairs and financial circumstances should be tabled:

- at the first meeting of creditors, or
- if the administrator allows directors a longer period to provide this statement - at the major meeting of creditors.

Recommendation 5. The reports sent by administrators when convening the major meeting of creditors should be required to include "any other matter material to the creditors' decision".

Recommendation 6. The period for holding the major meeting should be extended to 25 business days, with a new convening period of 20 business days.

The administrator should be permitted to hold the major meeting before the end of the convening period.

Recommendation 7. The convening period time should be calculated from the day after the administration begins.

Recommendation 8. The court's power to extend the convening period should be exercisable on an application made after the convening period has ended only where there would otherwise be substantial injustice to creditors. The court should have regard to the administrator's conduct when considering the costs of that application.

Recommendation 9. The current 60 day maximum time by which creditors can adjourn meetings should be reduced to 30 business days after the first day on which

the meeting is held. However, the court should be given a specific power to permit creditors to adjourn meetings to a date after that period, on application by the administrator.

Recommendation 10. All the directors of a company under administration should be required to attend creditors' meetings, but should not be obliged to answer questions. A director should only be excused from attendance if:

- the director can show reasonable cause for failure to attend, or
- the director's absence has been approved by the administrator or by a resolution of the creditors.

In addition, creditors at each meeting should have the power to direct attending directors to leave the meeting for all or part of the remainder of that meeting.

Recommendation 11. The administrator and the company should execute a deed that is fully approved at the major meeting within 15 business days of its approval, or such further period as the court allows on application made by the administrator within those 15 business days.

Recommendation 12. Where a deed is not fully approved at the major meeting, the administrator must draft a deed within 10 business days following the creditors' decision at that meeting. The court should have a power to extend this time on application by the administrator within that 10 business day period. Creditors should thereafter have 3 business days to inspect the draft deed. The administrator and the company should execute the deed within 2 business days following the end of the inspection period. However, the court should have a power to extend that 2 business day period for executing the deed on application by the administrator within that period.

Creditors should be informed at the major meeting:

- of their rights to inspect and comment on the draft deed
- that the final executed deed may not be in accordance with the draft document and that the administrator retains the ultimate responsibility for drafting the deed.

Voting at creditors' meetings

Recommendation 13. The current dual majority by value and number voting requirement, with the administrator having a casting vote to resolve any deadlock, should be retained.

Recommendation 14. The current court power to overturn a resolution whose outcome was determined by the votes of related party creditors should remain.

Recommendation 15. Directors and administrators should have a duty to disclose arrangements of which they are aware and under which persons are required, or may

become entitled, to vote a particular way on a proposal. That obligation should remain up to the time of the poll.

Recommendation 16. Secured creditors should be able to vote for the full amount of their debts in meetings while the company is under administration or under a deed of company arrangement.

Recommendation 17. Any person should be permitted to vote for or against any resolution in accordance with a special proxy, whether or not that vote is to the person's financial advantage.

Recommendation 18. Persons should be prohibited from voting general proxies for or against any resolution in which they are financially interested.

Recommendation 19. Employees should be permitted to vote on a deed of company arrangement as creditors, even if they have priority under that deed.

Recommendation 20. The court should be able to order that creditors who are also the owners of property that is pooled in a single enterprise forming part of the company's business should be a class of creditors for the purpose of voting on a deed of company arrangement. The deed should bind all those creditors if a majority in number, and three quarters in value, of those present and voting vote to accept the deed.

Effect of appointment of administrator on creditors

Recommendation 21. There should be no additional restriction on contractual provisions which enable a party dealing with a company to take certain action merely because the company appoints an administrator.

Recommendation 22. Persons who hold property of a company under administration as security under a lien or pledge should be entitled to retain possession of that property. However, they should not be entitled to exercise any rights under the lien or pledge to sell that property during the course of a voluntary administration.

Recommendation 23.

- Administrators should have a right to sell property subject to liens, pledges and reservation of title clauses, provided that the property is sold as part of the ordinary business of the company or as part of a sale of the business as a going concern to a third party. For the purpose of determining "the ordinary business of a company", any demand by a reservation of title creditor to return property should not, of itself, take any subsequent sale outside the ordinary business of the company. Likewise, a sale of property subject to a lien or pledge should not be outside the ordinary business of a company merely because the lienee or pledgee has possession of that property.

- . Lienees, pledgees or reservation of title creditors should have a right to apply to the court if they consider that they will be prejudiced if the sale of the property were to proceed.
- . Where that property is also subject to a charge, the administrator may sell the property only if the sale is in the ordinary course of business, with the written consent of the chargee or with the leave of the court.
- . Potential purchasers should have a statutory right of reasonable access to inspect any property held by lienees or pledgees.
- . The purchaser should obtain clear title to the property being sold, including the right to possession.
- . Administrators who exercise these rights of sale should have an immunity from any action in conversion.
- . In the case of property subject to liens and pledges, the administrator's right should be subject to an obligation to retain the amount secured by the lien or pledge and by any other security over the property having a higher priority in law or equity than the lien or pledge, for payment to the holders of those securities. If the administrator sells the property for a lower amount, the administrator should be personally liable for the shortfall.
- . In the case of property subject to a reservation of title clause, the administrator's right should be subject to an obligation to retain the invoice price of the property and any amount due to a person with a higher priority over that property, for distribution to the reservation of title creditor and that other person, if any. If the administrator sells the property for a lower amount, the administrator should be personally liable for the shortfall.
- . Administrators should have a right to apply to the court for an order enabling them to sell property held by lienees or pledgees or subject to a reservation of title clause without incurring personal liability where that immunity from liability would be reasonable in all the circumstances.

Recommendation 24.

- . Except where another creditor has a higher priority, the administrator may agree to a lienee, pledgee or reservation of title creditor selling the property and retaining an amount to cover the relevant debt (and returning any surplus to the administrator). Where this occurs, the administrator would have no personal liability to the selling creditor, even where the sale price is less than the debt.
- . Creditors should not be able to exercise rights of sale under distress for rent, or workers' liens, during an administration.

Recommendation 25. There should be an exemption from the moratorium under Part 5.3A for:

- bankers' liens
- shares lodged as collateral with any recognised clearing house.

Recommendation 26. The court's power to grant an injunction against enforcement action by a chargee over particular property, on application by an administrator, should be extended to cover injunctions against threatened enforcement actions.

Recommendation 27. Chargeholders who are permitted by the Corporations Law to enforce their charges should be able to do so during the administration period through court enforcement, as well as extra-curial, action.

Deeds of company arrangement

Recommendation 28. The court power to bind secured creditors or owners or lessors of real or personal property to a deed of company arrangement should only be exercisable after the creditors have resolved that a deed of company arrangement be executed.

Recommendation 29. The prescribed provision dealing with making claims should be amended by:

- adding the words "with such modifications as may be necessary"
- stating that a reference to "the relevant date" means a reference to the date of the administrator's appointment
- referring to the regulations which deal with proof of debt procedures in a liquidation.

Recommendation 30. The prescribed provision dealing with priority payments under a deed of company arrangement should incorporate all the priority provisions, not just s 556.

Recommendation 31. The prescribed provision dealing with meetings should be deleted.

Recommendation 32. The prescribed provisions should provide for, rather than require, the establishment of a committee of inspection.

Recommendation 33. A company should have an express right to apply to the court for an order that the company need not include the words "subject to deed of company arrangement" on its public documents.

Recommendation 34. It should be made clear that a debt which is extinguished by entry into a deed of company arrangement, and which by its terms would have otherwise survived, is deemed not to have been extinguished for the purpose of enforcing a related guarantee or indemnity.

Recommendation 35. Any deed of company arrangement should only terminate:

- through a resolution of creditors following a material breach of the deed that has not been rectified before the resolution is passed
- in circumstances contemplated by the deed itself, or
- by an order of the court, on application by a creditor of the company, the company, or any other interested person. The court, in deciding whether to terminate a deed, should be required to take into account the rights of third parties.

Administrators and deed administrators

Recommendation 36. All administrators (whether appointed under s 436A, 436B or 436C) should be required to table a statement of interest at the first meeting of creditors. The statement should disclose any professional, personal and business relationships of the administrator and his or her firm with the company or its officers, members or creditors that the administrator knew or should have discovered upon reasonable inquiry, including as an accountant or other professional adviser (other than the relationship arising merely from the company's request that the person be an administrator).

Recommendation 37. The administrator of a company should be permitted to consent to a transfer of shares in the company or an alteration in the status of the company's members if such a transaction is, in the administrator's opinion, in the best interests of the creditors of the company. The court should continue to have the power, on application by the prospective transferor or transferee of the shares, to consent to a transfer of shares or an alteration in the status of a company's members. An application to the court should only be permissible where the administrator has refused to consent to the transfer.

Recommendation 38. Administrators should be able to obtain approval of their fees:

- by agreement between the administrator and the committee of creditors
- by resolution of creditors generally where they have notice that this matter is to be considered, or
- by the court.

If a meeting of creditors is convened for this purpose after the administration has concluded, the cost of the meeting should be an expense of the administrator personally, without any right of indemnity out of the company's property.

The administrator's report to creditors should include a disclosure of the administrator's past and projected fees and expenses.

Recommendation 39. Administrators should continue to be personally liable for debts incurred in the performance or exercise of any of their functions and powers.

Recommendation 40. An administrator should not be taken to have adopted any employment contract entered into by the company unless the administrator does so expressly in writing. It should be made clear that any adoption of an employment

contract only relates to entitlements that accrue during the period of the administration. Any Federal, State or Territory legislation relating to employment contracts that is inconsistent with this recommendation should be overridden.

An administrator of a company should be personally liable for the wages of the company's employees who continue to provide services with the administrator's express or implied authority. An administrator should not be taken to have given implied authority for the provision of services by an employee of whom the administrator was unaware, provided that the administrator has taken all reasonable steps to identify all the company's employees.

Recommendation 41. 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.

Recommendation 42. Deed administrators should only have a power to sell existing shares in the company either with the prior approval of the holder of those shares or with the leave of the court. Members, creditors and the Commission should have standing to oppose a court application for leave.

Recommendation 43. Administrators and deed administrators should be required to lodge with the Commission accounts of receipts and payments.

Winding up proceedings prior to an administration

Recommendation 44. The court should have the power, on application by a creditor of a company, to make an order appointing an administrator to that company.

Recommendation 45. The Corporations Law should explicitly provide that the directors of a company to which a liquidator or provisional liquidator has been appointed cannot appoint an administrator.

Recommendation 46. The Corporations Law should explicitly provide that a chargee over all or substantially all the property of a company to which a liquidator or provisional liquidator has been appointed cannot appoint an administrator.

Recommendation 47. A liquidator should be entitled to appoint himself or herself as administrator:

- with the approval of the creditors of the company, or
- with the leave of the court.

Recommendation 48. The leave of the court or the approval of creditors should be required for a liquidator or provisional liquidator to appoint his or her business partner, employee or employer as administrator of a company.

Recommendation 49. A deed administrator should have the right to apply to the court for an order terminating a winding up. In determining that application, the court should be directed to have regard to:

- any misconduct of the company's officers reported by the administrator, the liquidator or the Commission
- the commercial decision of creditors in accepting the deed of company arrangement
- whether the deed of company arrangement would leave the company insolvent, and
- such other matters as the court thinks fit.

Recommendation 50. In addition to the Commission, a creditor or a member of a company, a liquidator or provisional liquidator who has put the company into administration should have the right to apply to the court for replacement of an administrator.

Liquidation following an administration

Recommendation 51. Transactions that take place during the course of a voluntary administration (including during the administration of a deed) that precedes any form of court or voluntary winding up, other than:

- transactions performed by or with the authority of an administrator or a deed administrator (even if in fact performed by the directors)
- transactions that are specifically authorised by a deed of company arrangement and carried out by the administrator of that deed

should be subject to the voidable transaction provisions.

Recommendation 52. Where:

- a company goes into liquidation after a voluntary administration
- an application for winding up has been made before the commencement of the administration, and
- the winding up application has not been dismissed

the relation-back day should be the day on which the application for the winding up order was filed (regardless of whether the company is wound up by virtue of that application), not the date of the appointment of the administrator. Dispositions by the administrator are not to constitute voidable dispositions.

Recommendation 53. The officer in control of a company under administration, or under a deed of company arrangement, immediately before the company proceeds into liquidation should be required to lodge with the Commission, at the time the company goes into liquidation, the s 439A report and a further report on:

- any matters not referred to in the s 439A report, and/or
- any material changes to matters referred to in that report

which affect the financial position of the company and of which that person has become aware before the date of the further report.

Recommendation 54. Creditors should have the right to appoint their own nominee as liquidator when a company under administration goes into winding up. If creditors do not appoint their own nominee, the administrator or deed administrator should become the liquidator.

Recommendation 55. Where a liquidation follows a deed of company arrangement, post-deed creditors should have no statutory priority, except where the deed administrator is personally liable for debts covered by s 556(1)(a).

Creditors voting at the major meeting should have the right to include in a deed of company arrangement any other form of priority for post-deed creditors.

The current priority rights for debts incurred by administrators should remain.

Recommendation 56. Creditors' voluntary winding up should be abolished.

Implications for takeovers and fundraising

Recommendation 57. There should be no exemption from the takeover provisions for an acquisition of shares pursuant to a voluntary administration.

Recommendation 58. There should be an exemption from the fundraising provisions for offers or invitations to creditors to exchange debt for equity under a deed of company arrangement.

Other matters

Recommendation 59. All references to days in Part 5.3A should be to "business days".

Recommendation 60. Any company that changes its name during the course of, or in the 6 months before, a voluntary administration should be required to disclose its former, as well as its current, name on its public documents for the period of that administration or any subsequent liquidation.

Appendix 2

List of Respondents

Allen Allen & Hemsley For QIDC Ltd
Australian Bankers' Association
Australian Credit Forum
Australian Finance Conference
Australian Institute of Credit Management
Australian Stock Exchange
The Discussion Group
Ernst & Young, Sydney
Ferrier Hodgson (Queensland)
Richard Fisher, Blake Dawson Waldron
Horwath, Sydney
IPAA Melbourne Forum
David Kerr, Lord & Brown
KPMG
Law Council of Australia
Geoff McDonald, Love & Rodgers
Major Airconditioning & Refrigeration Suppliers
Richard Brien & Co
Robert MH Cole & Co
SLD Consultants Pty Ltd
Voluntary Administration Law Reform Committee (VALRC)
John Wardlaw, Lewis Hutchinson
Westpac Banking Corporation