CAMAC DISCUSSION PAPER

REHABILITATING LARGE AND COMPLEX ENTERPRISES IN FINANCIAL DIFFICULTIES

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Preliminary Issue

Insolvency laws are at least unusual to the extent that, in certain circumstances, they permit intrusion upon the accrued property and other rights of third parties. The starkest example of that intrusion is to be found in the antecedent transaction provisions.

Likewise, the voluntary administration regime intrudes upon the rights of, say, secured creditors and the lessors of property which is in the company's possession. The justification for that intrusion, from a policy perspective, reflects the desirability of an independent assessment being made of whether a financially troubled company or its business might be rehabilitated. However, there is protection for the positions of such third parties, including:

- the limited time which is available in the ordinary course for the review of the company's affairs to be undertaken;
- the requirement that rent be paid to the lessor of any property in the company's possession in the circumstance that that property is being used; and
- the exclusion of the moratorium provisions when enforcement action has been commenced either by a secured creditor or by the owner or lessor of property which is in the company's possession.

To the extent that amendments are proposed to be made to the voluntary administration regime, a consideration which may be important is the need to maintain a balance between providing an adequate opportunity to assess the prospects for a company or its business and infringing upon the rights of third parties.

Of course, when assessing the appropriateness of any balance which is to be struck, it is also pertinent to bear in mind that the voluntary administration regime is intended to provide, and does provide, no more than an interim form of administration for the company's affairs pending a decision by its creditors as to which option for the company's future best suits their interests.

It is submitted that the flexibility presently found in the voluntary administration regime enables any issues arising in the course of administering the affairs of a company or enterprise, irrespective of size, to be resolved expeditiously by way of application to the court, thus providing a forum to any third party whose interests may be affected in which to effectively vent any concerns it may have as to the proper protection of those interests.

"Large and Complex" Companies

If some distinction is to be drawn between "large and complex" companies and other companies, it is submitted that resort should be had to the existing distinction in the Corporations Act between "public companies and large propriety companies" on the one hand and "small propriety companies" on the other hand.

Principles for Effective Corporate Rehabilitation

The Harmer Report commended the following tests to assess the voluntary administration regime: "(I)t would be:

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

It is submitted that those tests continue to be relevant.

Funding

Two general issues are raised in the context of the Discussion Paper's consideration of that environment which is requried to facilitate a rehabilitation on which I would like to comment.

First, access to funding will be critical to the success of many administrations where they are a prelude to the rehabilitation of a company or enterprise.

It is submitted that, at least, any loan funds raised by the administrator should enjoy the same priority as all other costs and expenses of the administration as well as being liabilities for which the administrator is personally accountable. Moreover, any doubt about the administrator's ability to raise equity funding should be resolved.

It is further submitted that consideration should be given to permitting DIP loan financing of the kind available in the United States but subject to the protection required by that country's Bankruptcy Code.

In this regard, the Corporations Act already recognises the possibility that, in some cases, it is appropriate to permit the adjustment of the rights of secured creditors in the interests of a company's general body of creditors subject to there being adequate protection for the interests of the secured creditor; Section 434B, *Corporations Act*.

A related issue concerns the present limitation on the right of the administrator to contract out of personal liability for debts incurred in the course of the company's voluntary administration. In the context of many informal workouts, finance creditors will, in the first instance, effectively subordinate their claims to those of a company's trade creditors in order to permit it to continue to conduct its business.

It is submitted that consideration be given to permitting an administrator to contract out of personal liability or to limit personal liability in the circumstance, e.g., where an existing creditor is prepared to continue to support the company by providing "fresh" credit against, say, some right of priority in respect of its pre-administration debt. As with Section 564, *Corporations Act*, such agreements might be made subject to the court's approval.

Corporate Groups

The second general issue concerns corporate groups. Where a corporate group is engaged in one industry, as, e.g., with the Ansett group, the conclusion that the affairs of the group should be administered on a consolidated basis might be seen as inescapable. However, as our commercial history demonstrates, some corporate groups which collapse are truly conglomerates. Bond Corporation is a prime example having been involved in at least brewing, newspaper publishing, mining and property development. What rationale can be advanced for supporting the conclusion that a supplier of newsprint should compete with a supplier of yeast as "creditors" of the mining companies in such a group?

It is submitted that, to the extent that it is not already the case, this issue is resolved not by some general prescription but by making it plain that Section 439A, *Corporations Act*, is of as much relevance in dealing with a thorny issue of this kind as it is for, say, extending time limits.

Procedural Issues

Turning to some particular issues raised by the Discussion Paper, I deal with them in the order in which they are raised:

- ***Eligibility for Appointment as a Voluntary Administrator***

  Nothing in the evolution of the regime has caused me to think that the Harmer Report was wrong in recommending that eligibility for appointment as a voluntary administrator should be confined to a small group of well-regarded insolvency practitioners.

- ***Voting***

  The issue not raised by the Discussion Paper is whether the class rules which apply to schemes of arrangement or some modification thereof should apply to voting by creditors at meetings held in the course of a voluntary administration. It is notorious that in the administration of the Ansett Group the employees exercised considerable influence through their ability to dominate meetings. However, it would have been invidious if creditors whose interests were entitled to preferential treatment could have determined, in effect, that the Group should continue to trade even if it were to do so at a loss. In such a circumstance, the general body of creditors would have been underwriting those losses without the employees suffering any detriment, at least in the first instance.

  Alternatively, some other means of protecting the interests of an "opressed" class needs to be identified.

- ***Avoiding Antecedent Transactions***

  As mentioned at the outset, the provisions which facilitate the avoidance of antecedent transactions are a prime example of the intrusion by the insolvency law into the accrued property rights of third parties. Their rationale, as is well known, is that where the law requires the estate of a debtor to be realised and the proceeds distributed amongst its creditors, it is "unfair" for the beneficiaries of some transactions to retain the benefit of those transactions as against the debtors' creditors.

  Where there is no such "drawing of a line in the sand" and the debtor's affairs are to be rehabilitated, it is problematic as to whether it is appropriate for the antecedent transaction provisions to be invoked. My uncertainty in dealing with this issue is that most often it seems to be the case that even where there is a deed of company arrangement as distinct from a liquidation following on from a voluntary administration, the only distinction between the deed of company arrangement and the liquidation is that creditors are offered a larger dividend under the deed that which is speculated (by the voluntary administration) as being available in a liquidation.

Such arrangements, in my view, raise broader policy questions; see, e.g., *re Brian Cassidy Electrical Industries Pty Limited* (1984) 9 ACLR 140. However, it is hard to resist the conclusion that creditors should have access to the benefit of the antecedent transaction provisions if that is the substantial effect of a deed.

- ***Equity for Debt Swap***

Save for such regularity intervention as is necessary to ensure that creditors make a fully informed decision to accept equity for debt (and that intervention should be through Part 5.3A of the *Corporations Act*) <u>it is submitted that</u> the other provisions which apply either to invitations to subscribe for capital in a company or to the acquisition of more than a prescribed percentage in a company's capital, should not impact upon an equity for debt swap effected by means of a deed of company arrangement.

In relation to the takeover provisions, it is worth bearing in mind the observation of Sir Laurence Street in *Kinsella v Russell Kinsella Pty Limited (In Liquidation)* (1986) 4 NSWLR 722 to the effect that once a company is insolvent it is the creditors whose interests are at risk and it is to those interests which the directors must have regard when exercising their powers. If it be the case that a creditor is owed more than, say, 20% of the total indebtedness of an insolvent company then so be it.

A related issue concerns the power (or lack thereof) of a voluntary administrator or the administrator of a deed of company arrangement to deal with the capital of the company which was issued as at the commencement of the administration. <u>It is submitted that</u> the existence of that power should be statutorily clarified and confirmed; *Mulvaney v Rob Wintulich Pty Limited* (1995) 60 FCR 81.

- ***Set-off***

Consistently with the general premise advanced at the outset of these submissions, <u>it is submitted that</u> unless there are good policy reasons to do so, rights of set-off accrued as at the commencement of a voluntary administration should not be disturbed.

Referring to the particular example in the Discussion Paper, there is no reason in policy or principle not to disturb rights which supposedly arise after that date.

As to whether rights have accrued prior to that date may be disturbed:

- there is the issue raised in the Harmer Report as to whether rights of set-off which might be caught by the antecedent transaction provisions, or a modification thereof, should be able to be extinguished;

- there may be an argument that draws an analogy between an asset to which a right of set-off applies and an asset the subject of a floating charge; Section 443E, *Corporations Act*;

but any modification of such a right should be based on proper considerations of public policy and not on grounds of mere convenience.

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