



Australian Government

Corporations and Markets
Advisory Committee

Rehabilitating large and complex enterprises in financial difficulties

Report
2004

Corporations and Markets **Advisory**
Committee

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complex enterprises in
financial difficulties

Report

October 2004

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7 October 2004

The Hon. Peter Costello, MP
Treasurer
Parliament House
Canberra ACT 2600

Dear Treasurer

I am pleased to present a report prepared by the Advisory Committee on *Rehabilitating large and complex enterprises in financial difficulties*.

The report responds to a reference given to the Committee in September 2002 by Senator the Hon. Ian Campbell, in his then capacity as Parliamentary Secretary to the Treasurer.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard St John'.

R.A. St John
Convenor

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1 Overview

Background to report, overview of findings and conclusions, and reference to the recent Parliamentary Committee report on insolvency.

1.1 Corporate rehabilitation

The aim of any corporate recovery process is to give financially distressed enterprises that may still be viable in the longer term a realistic opportunity to overcome their financial problems and continue in business. The return of an enterprise to profitability rather than winding it up may benefit a range of affected parties, including financiers, suppliers, employees, customers and shareholders.

The two principal procedures to assist corporate recovery under the *Corporations Act 2001* are:

- *a scheme of arrangement* (Part 5.1): a longstanding court-based procedure that allows companies to reorganise their affairs with the consent of a prescribed majority of their shareholders and/or creditors (depending on who is affected by the scheme) and the approval of the court
- *voluntary administration* (Part 5.3A): allows directors to place the company under the control of an administrator with a view to its rehabilitation, or liquidation where corporate recovery is not possible.

Voluntary administration (VA) has emerged as the principal corporate rehabilitation procedure in Australia since its introduction in 1993. It has been used for various large and complex enterprises, including Ansett and Pasminco, as well as for numerous small and medium enterprises.

1.2 Terms of reference

In September 2002, the then Parliamentary Secretary to the Treasurer, Senator the Hon. Ian Campbell, referred the matter of rehabilitating large and complex enterprises to the Advisory Committee. In so doing, Senator Campbell noted that:

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

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

- Are there particular difficulties in applying Part 5.3A to large and complex enterprises?
- If so, could the Committee recommend the most appropriate course of action to deal with those difficulties? This could include:
 - particular changes to Part 5.3A to better accommodate large corporate rehabilitation cases;
 - particular changes to the rarely used Part 5.1 (arrangements and reconstructions) provisions to accommodate large corporate rehabilitation cases;
 - a new system for corporate rehabilitation, along the lines of Chapter 11 of the United States Bankruptcy Code; or
 - any other action that the Advisory Committee considers appropriate.

Senator Campbell also requested that, in considering these matters, the Committee have regard to balancing the objectives of ensuring

appropriate avenues for rehabilitation of viable businesses with the importance of preserving, so far as possible, the rights of security holders and keeping administrative cost and delay to a minimum.

1.3 Related Advisory Committee reports

The terms of reference referred to the Advisory Committee's *Corporate Voluntary Administration Report* (June 1998) (the 1998 VA report). That report endorsed the VA procedure as a valuable and successful form of corporate recovery. It made various recommendations to overcome a number of anomalies that had become apparent in the procedure's first years of operation, together with other recommendations to enhance its functioning.

In addition, the Advisory Committee's *Corporate Groups Report* (May 2000) recommended amendments to the VA provisions to accommodate the pooled administration of two or more group companies.

The full text of both reports is available under *Reports* on the CAMAC Website www.camac.gov.au.

1.4 The review process

1.4.1 The Discussion Paper

In September 2003, the Advisory Committee published a Discussion Paper that examined a range of issues that apply to the rehabilitation of large and complex enterprises. The Paper compared the Australian VA procedure with the procedure under Chapter 11 of the United States Bankruptcy Code (Chapter 11) and the UK procedure under the Enterprise Act 2002 in the context of five principles for effective corporate rehabilitation, namely:

- the earlier a company responds to its financial difficulties, the better may be its prospects of successful rehabilitation
- the prospect of a financially distressed company being rehabilitated may be improved if it can be encouraged to enter into discussions with its major creditors as early as possible on how best to rectify its financial position

- a company may have a better prospect of successful recovery if it can obtain new loan or equity finance during the rehabilitation period
- the procedural timetable needs to be sufficiently flexible to adjust to the needs of particular companies
- the process of rehabilitating a corporate group may be assisted if that group can be dealt with collectively, rather than on a company-by-company basis.

The Discussion Paper then raised for consideration which of the following options may best provide for the needs of large and complex enterprises:

- maintain the current Australian corporate rehabilitation structure, possibly with some amendments to the VA and/or scheme of arrangement provisions
- introduce an additional rehabilitation procedure based on Chapter 11
- replace VA with a rehabilitation procedure based on Chapter 11.

1.4.2 Submissions

The Advisory Committee received submissions on its Discussion Paper from various respondents, who are listed in Appendix B to this report.

The Advisory Committee thanks all respondents for their submissions, which were of high quality and provided useful information. The responses greatly assisted the Committee in developing and refining its views.

This report contains a brief summary of the submissions on each of the issues raised. The submissions are available on the CAMAC Website www.camac.gov.au.

1.4.3 Structure of the report

This report reviews all the issues identified in the Discussion Paper, taking into account the responses and other matters raised in submissions.

The format adopted in discussing each issue is as follows:

- a reference to the relevant paragraphs of the Discussion Paper (where the background to the issue, relevant law and various policy options are set out)
- a concise statement of the issue, which also includes a summary of the current law where necessary. In a few instances, the current law is summarised under a separate heading
- a summary of the submissions
- a statement of the Advisory Committee's recommendation
- the Advisory Committee's reasons for its recommendation
- reference to the Parliamentary Joint Statutory Committee on Corporations and Financial Services report *Corporate Insolvency Laws: a Stocktake* (June 2004), where relevant.

All references to legislation in this report are to the *Corporations Act 2001*, unless otherwise indicated.

1.5 Conclusions

The responses to the questions posed in the terms of reference (1.2, above) are as follows.

Should a new system of corporate rehabilitation along the lines of Chapter 11 of the United States Bankruptcy Code be adopted in Australia?

The Advisory Committee finds no compelling need, or intrinsic shortcoming in the VA procedure, which requires or justifies adopting Chapter 11 as an additional or substitute corporate recovery procedure for large and complex, or other, enterprises.

There was general support in submissions for the five principles for effective corporate rehabilitation set out in the Discussion Paper, though respondents also considered that these do not constitute a decisive argument for preferring either Chapter 11 or VA. Both procedures seek to achieve corporate rehabilitation, albeit through quite different methods.

There was overwhelming support in submissions for retaining VA and not introducing Chapter 11. Chapter 11 is a longstanding and commonly utilised corporate recovery procedure in the USA. However, it could not be introduced into Australia without fundamental changes to the rehabilitation process and the role of the courts, for which there is no apparent demand.

Are there any particular difficulties in applying Part 5.3A to large and complex enterprises?

The Advisory Committee has not identified any fundamental difficulties in applying the VA provisions to large and complex enterprises, or any circumstances where it is necessary to have separate corporate recovery regulation for these enterprises.

Some issues dealt with in this review (for instance, timing of creditors' meetings) are more likely to arise in the administration of large and complex enterprises, while other issues (for instance, rights of substantial chargees) may be relevant in any type of administration. Any necessary changes can be accommodated within the VA legislative structure.

Are there any particular changes required to Part 5.3A better to accommodate large corporate rehabilitation cases?

The Advisory Committee concludes that Part 5.3A is fundamentally sound. In some respects, however, the workability of VA for large and complex, as well as other, enterprises could be further enhanced by legislative amendments to:

- permit administrators to notify pre-commencement creditors through electronic means (2.5 and Rec 6)
- increase incrementally the time period for holding the first and major meetings (2.6 and Rec 7)

- require an administrator to give reasons in exercising any casting vote (2.8 and Rec 10)
- stipulate more appropriate qualifications for persons who will act as administrators (3.1 and Rec 15)
- permit committees of creditors to approve administrators' remuneration (3.4 and Rec 18)
- permit deed administrators to sell or cancel equity with the consent of the holder or the leave of the court (3.8 and Rec 22)
- increase incrementally the decision period for substantial chargees to appoint a receiver, and permit them to enter into agreements with administrators to extend further that period (4.1.2 and Rec 24)
- permit unsecured creditors, by special resolution, to give a post-administration creditor priority over all unsecured creditors (5.1 and Rec 31)
- permit corporations to be members of a committee of creditors (5.2.3 and Rec 34)
- provide prospectus relief for equity for debt swap offers (a refinement of the 1998 VA report recommendation) (5.3.2 and Rec 35)
- clarify that deeds of company arrangement may include mandatory equity for debt swaps (5.3.4 and Rec 37)
- clarify that a deed can depart from the statutory winding up priorities (5.4 and Rec 39)
- permit pooling (a refinement of the 2000 *Corporate Groups Report* recommendation) (6 and Recs 40–42)
- give liquidators at least one year from the date of their appointment to commence litigation to undo voidable transactions (7.8 and Rec 50).

The full set of recommendations in this report, divided into matters that should and should not change, is set out in Appendix A. These recommendations are additional to those in the 1998 VA report

(other than Rec 38 of the 1998 report which is modified by Rec 18 of this report, Rec 44 of the 1998 report which is superseded by Rec 5 of this report, and Rec 58 of the 1998 report which is refined by Rec 35 of this report). Also, Rec 20 of the 2000 *Corporate Groups Report* is refined by Recs 40–42 of this report.

Are there any particular changes required to Part 5.1 arrangements and reconstructions to accommodate large corporate rehabilitation cases?

The Advisory Committee does not propose any changes to the creditors' schemes of arrangement provisions to accommodate large and complex enterprises.

1.6 Parliamentary Committee report

In June 2004, the Parliamentary Joint Statutory Committee on Corporations and Financial Services (PJC) published a report *Corporate Insolvency Laws: a Stocktake* (PJC report), available on the Australian Parliamentary website www.aph.gov.au. The range of matters considered by the PJC report included, but extended beyond, VA. For convenience, the conclusions or recommendations of that report that are relevant to matters dealt with in this report are noted below.

In the following areas, there was broad consistency between the PJC report and this report.

Topic	PJC report	Advisory Committee report
Not adopt US Chapter 11 or business turnaround model	Chapter 5 (paras 5.50, 5.75)	2.1.1 and 2.1.2 and Recs 1 and 2
Permit electronic notification of creditors	Rec 20	2.5 and Rec 6
Incrementally increase time for holding first meeting	Rec 15	2.6 and Rec 7
Incrementally increase time for holding major meeting	Rec 16 (other than the last sentence)	2.6 and Rec 7
Broaden categories of person who may be administrator	Rec 5	3.1 and Rec 15
No roster system for administrators	paras 3.47–3.53	3.1 and Rec 15
Retain right of substantial chargee to appoint receiver	paras 6.45–6.48	4.1.1 and Rec 23
Retain requirement to prepare and lodge financial reports	Para 6.91	7.1 and Rec 43
Retain requirement to hold annual general meeting	Para 6.91	7.2 and Rec 44

The PJC and this report reached differing conclusions on the following matters.

Topic	PJC report	Advisory Committee report
Grounds for initiating VA	Rec 14 (is or 'may be' insolvent)	2.3 and Rec 4 (retain current law)
Administrator using casting vote	Rec 3 and Rec 25 (limited prohibitions)	2.8 and Rec 10 (no prohibition)
Substantial chargee's decision period	Paras 6.45–6.52 (retain 10 business days)	4.1.2 and Rec 24 (15 business days and any further agreed extensions)
Ipso facto clauses	Rec 55 (courts can override)	4.2 and Rec 28 (fully enforceable)
Priorities in a deed	Rec 49 (follow the winding up order of priorities)	5.4 and Rec 39 (not have to follow the winding up order of priorities)

1.7 Special Commission of Inquiry report

The report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation (conducted by David Jackson QC), published in September 2004, referred (in Volume 1, pp 573–575) to difficulties that may arise in the external administration of a company that has substantial long-tail liabilities. In this context, the Commissioner referred to a mechanism, available under US Chapter 11, to appoint a future claimants’ representative to deal with these liabilities.

The Advisory Committee considers that the issues referred to go beyond voluntary administration and cannot adequately be dealt with in the context of this report.

1.8 Proposal on grouping of entities

In September 2004, the firm of KordaMentha submitted a Research Paper *Grouping of Entities in the Event of Insolvency*, which developed and expanded on its earlier submission. The paper recommended ‘requiring by law in the event of insolvency that all assets of companies within a group should be available to meet all of the liabilities of the companies within the group’. However, ‘legislation should also enable a company within a group to elect to “opt out” such that its assets and liabilities will not be pooled’. The paper is available on the CAMAC website www.camac.gov.au under *Submissions*.

While the Advisory Committee deals with aspects of grouping in its consideration of pooling (Part 6 of this report), it considers that the matters canvassed in the paper extend beyond the scope of this report.

1.9 Summary of US Chapter 11

The Discussion Paper contained summaries of relevant aspects of US Chapter 11, dealt with under particular issues. For ease of reference, Appendix C brings this material together.

1.10 Comparison of VA and schemes of arrangement

Appendix D reproduces the comparison of creditors' schemes of arrangement with voluntary administration that was contained in the Discussion Paper.

1.11 Committee members

Information about the Advisory Committee, its Legal Committee and their members is set out in Appendix E.

2 The rehabilitation process

Should a US-style debtor in possession approach be introduced as an additional or replacement corporate recovery procedure in Australia? Should there be any changes to the grounds for initiating a VA and the method of conducting it?

2.1 Choice of process

2.1.1 Debtor in possession or voluntary administration

[Discussion Paper paras 1.15–1.38]

The issue

Should a ‘debtor in possession’ procedure based on Chapter 11 be introduced in Australia as an additional, or substitute, corporate rehabilitation process?

VA and Chapter 11 are both designed to provide an opportunity for companies in financial difficulty to reorganise and continue in business if they have value as a going concern, rather than merely go into liquidation. However, under Chapter 11, the management usually stays in control, with the bankruptcy courts having a central supervisory and approval role. Under VA, an external administrator controls the company, with the court only having a role if requested by the administrator or any other eligible person.

Submissions

Submission favouring debtor in possession approach

One submission took the view that a debtor in possession reorganisation system may encourage boards to take early remedial action, given that they remain in control. It could be introduced into Australia, with the following features:

- a commercially sensible period within which the company can negotiate a reorganisation of its affairs
- external court supervision, possibly with the assistance of a person appointed by the court to report to it, to ensure that the company is acting in good faith and for a proper purpose in going into rehabilitation (for instance, not merely to defeat creditors, obtain a debt holiday or gain a competitive advantage)
- the company only continues to receive protection if, in the view of the court, a reconstruction plan remains viable and is not unfair or oppressive to a class of creditors.

Submissions opposing debtor in possession approach

Most submissions favoured retaining the current VA provisions, with some modifications, rather than introducing any additional or substitute procedure based on Chapter 11 for all, or for large and complex, enterprises. They considered that the VA structure, with the court's residual powers, is generally flexible enough to deal with the restructuring of large and complex enterprises (as exemplified in the Ansett and Pasmenco administrations), as well as smaller enterprises. The same VA provisions should apply to all enterprises, regardless of size or complexity.

Respondents raised many arguments for retaining the current approach and not introducing Chapter 11, including:

- External controller
 - the rehabilitation of a financially distressed company should be controlled, and its capacity to continue as a going concern assessed, by an independent and suitably experienced, qualified, adequately resourced and licensed or registered external party
 - hard and quick decisions may be made more readily by an external party than by directors under stress (though under VA directors can suggest to the administrator appropriate ways to improve the company's position)
 - removal of the board does not necessarily result in a loss of management expertise, as the board and management of large companies are usually separate. Also, nothing in VA

prevents an administrator from engaging industry and other experts in particular cases

- the main factors contributing to the failure of most companies are poor management and lack of adequate corporate governance. The directors who caused or contributed to the financial difficulties of a company rarely have the ability, objectivity or lack of self-interest to take the necessary remedial action. Furthermore, if left in charge, they may even initiate high risk strategies on the basis that they have nothing to lose and a lot to gain by speculative investment of the company's resources, thereby increasing shareholders' losses and placing competitor companies at risk
 - the best deterrent against misusing a rehabilitation procedure to create an unfair competitive advantage is to take the actual facilitation of the restructuring out of the hands of those who initiate it, namely, the directors
 - the board of directors, if left in control, may not negotiate with all creditors transparently or may seek to prefer some creditors to others
 - a debtor in possession regime may erode the current scope for administrators to report to ASIC on breaches of the Act and to report to creditors on potential claims against directors
- Impact on creditors
 - financial institutions or other creditors may not support a procedure that is not controlled by an independent appropriately qualified professional. Creditors may perceive a procedure that has no independent person involved in the reorganisation as being significantly weaker than the existing Australian insolvency regime
 - a debtor in possession regime would give the debtor (or its advisers) the first opportunity to prepare and present a plan. Creditors, lacking the advice of an independent administrator, would then need independent advisers to assess the debtor's proposals and may have to form separate classes, each separately advised, to reflect their different interests. As a result, the court would have to be given a far

more interventionist role to resolve disputes and give final approval to the plan

- Role of the court
 - a debtor in possession regime can be administratively more expensive, particularly given the high level of court involvement and related professional costs. An Australian equivalent of that system may also require establishing a separate court system to deal with the large number of applications that would be required
 - the limited supervisory role of the courts under VA was a deliberate recommendation of the Harmer Report. A debtor in possession regime would run counter to the well-accepted need to minimise the role of the courts
 - the quite appropriate reluctance of Australian courts to make decisions on commercial matters, in substitution for the discretion of the directors, is not readily compatible with the extensive court involvement in approving and monitoring corporate reconstructions under Chapter 11
 - US Bankruptcy Court approval is required for all major decisions, including asset sales. A comparable level of court participation in, for instance, the Ansett administration would have delayed and possibly derailed asset sales
- Impact on competitors
 - a Chapter 11 type procedure could be used to support poorly performing companies, to the detriment of the well-managed and efficient industry participants, who may come under pressure to adopt imprudent practices to maintain market share
- Reason for failure of Ansett recovery
 - there is no evidence that the debtor in possession approach would have saved Ansett, which needed capital. The US Airways Chapter 11 succeeded primarily because of a US\$900 million US government loan, US\$240 million of fresh equity and an injection of US\$100 million of at-risk debt, rather than in consequence of retaining the board of directors in control.

Recommendation 1

Voluntary administration, under which corporate control is transferred to an external administrator, should be retained. There is no clear case for introducing a debtor in possession regime based on Chapter 11 of the United States Bankruptcy Code, either as a substitute for voluntary administration or as an additional procedure.

Reasons

Most submissions agreed that there was no compelling case for fundamental changes to Part 5.3A along the lines of the debtor in possession model. Likewise, there was little support for adding to the Australian law an alternative system based on this model.

Part 5.3A has been a highly successful initiative to deregulate external administrations. It deliberately limits court involvement, given that creditors are protected by the appointment of an external administrator. By contrast, Chapter 11 depends on extensive judicial supervision to protect creditors, including a requirement of court approval for any actions by the company in Chapter 11 outside the ordinary course of its business. Australian courts are reluctant to become involved in commercial decision making, which requires non-judicial skills and knowledge (see, for instance, *Re Ansett Australia Ltd and Others (all admin apptd) and Korda* (2002) 40 ACSR 433 at 451 per Goldberg J). Also, the judicial infrastructure required for the operation of a Chapter 11 type regime in Australia is not currently available.

Parliamentary Committee report

The PJC was not persuaded that an insolvency procedure modelled on Chapter 11 was appropriate for the Australian corporate sector or that wholesale amendments to the VA procedure to conform with Chapter 11 would significantly improve the results that are presently achievable under VA (PJC report, para 5.75).

2.1.2 Business turnaround model

The issue

Should the business turnaround model be introduced as a substitute or additional rehabilitation procedure?

Summary of model

The Business Turnaround Association proposed the following.

A Turnaround Panel (controlled by ASIC or comparable to the Takeovers Panel) should be established. Its role would be to:

- receive submissions from medium to large companies in financial distress (the distress test being that the directors believe that the company may become insolvent within 12 months)
- determine whether to grant distressed companies a moratorium from paying unsecured creditors for six months, taking into account the current return to unsecured creditors and the likely increase in this return if a turnaround was successful
- monitor the turnaround process, including any reporting and timing requirements, with the power to end the moratorium if the stipulated goals are not achieved.

The Turnaround Panel would agree on who are to be the directors of the company during the turnaround period. The company's board, with the Panel's consent, would appoint a CEO to undertake the turnaround exercise. The CEO would have full control of the company's operations.

The directors would call a meeting of unsecured creditors within 21 days of the Turnaround Panel granting a moratorium, to explain the planned actions for the company's rehabilitation. Any dissenting creditor could make a submission to the Turnaround Panel, which could withdraw or alter the terms of the moratorium.

During the turnaround process, the board of directors could continue to trade. However, debts owed to unsecured creditors as at the date of the commencement of the turnaround would be excluded in determining whether the company was solvent for the purpose of s 588G. This amended solvency concept would enable new

continuing creditors to have normal commercial assurance that they will be paid.

Companies undergoing a turnaround would be exempt from the takeover provisions if the Turnaround Panel approved the scheme.

The Panel would have the power to override any ipso facto clauses that would impede a turnaround approved by the Panel.

If at the end of the six month period the company was operating profitably, but was unable to pay all its unsecured creditors, the company and the creditors would enter into a deed of company arrangement.

Recommendation 2

The Business Turnaround model should not be adopted as either a substitute or additional rehabilitation procedure.

Reasons

There is a growing trend in Australia, as well as overseas, for companies in financial difficulties to enter into voluntary arrangements with their creditors. Early intervention of this nature may considerably enhance the prospects of corporate recovery. However, the proposal to move beyond voluntary arrangements to the introduction of a Turnaround Panel leaves many unanswered questions, including how it would be funded and how it would encourage creditors to keep trading with the company. It would also remove the capacity for a company's creditors or shareholders to make key decisions about the rehabilitation process.

Parliamentary Committee report

The PJC report stated that the concept of a business turnaround culture has considerable merit, especially the incentive it provides for timely intervention by the directors before all hope of rescuing the company has gone. Nevertheless, the PJC did not recommend the introduction of a new procedure along the lines proposed by the Business Turnaround Association. It was concerned that the proposed procedure may significantly and adversely affect the rights of the creditors of the company, particularly unsecured creditors (PJC report, para 5.50).

2.2 Description of process

The issue

Would the rehabilitation objectives of VA be enhanced if the description of the process in Part 5.3A was changed to put more emphasis on the corporate recovery objective?

Submissions

Some submissions proposed ‘re-branding’ the Part 5.3A process to emphasise its true rehabilitative objects and to dispel any perception that it is merely a precursor to liquidation. However, no respondents suggested any specific alternative description of that process.

Recommendation 3

There is no need to change the current description of the Part 5.3A process.

Reasons

Any perception that VA is merely the first step towards liquidation could discourage directors from entering into VA until it is too late for the company to recover. However, there is no clear evidence of any such perception. In any event, perceptions may develop or change over time, depending on the success or otherwise of VAs in practice. Renaming Part 5.3A may not make any material difference in this respect.

2.3 Grounds for initiating VA

[Discussion Paper paras 1.6–1.14 and 2.23–2.30]

The issues

Should there be any change to the current threshold test for entry into a VA that the company is insolvent, or is likely to become insolvent at some future time?

Also, should the directors of a company that is insolvent no longer have the option of appointing an administrator, but only of putting the company into liquidation?

Submissions on possible alternative grounds

Retain current test

Submissions generally favoured retaining the current test over alternative tests.

Respondents noted that any interested person who believes that the company does not satisfy the current test or that the provisions of Part 5.3A are being abused may bring an action pursuant to s 447A(2).

Replace current test with a 'good faith' test or a combined financial stress and 'good faith' test

One argument put forward for including a good faith element was that under the current law directors may be inclined only to appoint administrators when the company is in a hopeless financial situation, given the uncertainty about when a company can be said to be 'likely to become insolvent at some future time'. Combining a financial stress test with a good faith test, while protecting companies genuinely seeking to respond to a reasonable prospect of insolvency by commencing discussions with creditors early, would prevent abuse by solvent companies simply seeking to obtain a debt holiday.

A contrary view in submissions was that a 'good faith' only test, or a combined good faith and financial stress test:

- may give rise to unnecessary litigation, given its uncertain ambit
- would require an increased level of court supervision of directors' decisions and motives (for instance, where they are merely seeking a debt holiday) that may be inconsistent with the general approach in the VA provisions of giving the court only a residual role.

Permit appointment where a company ‘may become insolvent’ or there is ‘a reasonable prospect of insolvency’

One argument put forward for a test of this nature is that it may overcome any perception that only insolvent companies use the VA procedure.

However, most submissions opposed any test of this nature, arguing that it may:

- be more speculative than the current test
- lead to increased litigation over whether the company was entitled to go into VA, and
- create a risk to creditors of abuse by companies seeking an unwarranted debt holiday.

Permit appointment when a solvent company is in financial difficulty

Submissions generally opposed this option, as:

- it could place the future of a still-solvent company in the hands of creditors, rather than the shareholders
- it is too uncertain and could significantly affect existing accounting principles, including the way liabilities are classified on the company’s balance sheet.

Submissions on prohibiting directors of an insolvent company from appointing an administrator

The principal arguments advanced in support of this prohibition were that it would:

- force directors to consider VA before the company actually becomes insolvent (knowing that VA would not be an option once the company was insolvent)
- discourage the use of the VA procedure to resurrect phoenix companies.

Submissions generally opposed this prohibition, for the following reasons:

- it is difficult to judge whether a company is insolvent or just approaching insolvency
- the current insolvency test, namely cash flow insolvency, is significantly different from balance sheet insolvency. A company with a surplus of assets that is cash flow insolvent may be the perfect candidate for a restructuring through a VA and a deed of company arrangement, particularly if the company's cash position has been adversely affected by unforeseen, temporary events, for instance supply problems
- having liquidation as the only option available to directors of an insolvent company, with liquidators subsequently using their current powers to place those companies into VA if appropriate, would introduce a time-consuming intermediate step to VA, with no apparent benefit
- the legal consequences of directors appointing an administrator in the belief that the company is not currently insolvent, though it is 'likely to become insolvent at some future time', would be unclear if the company subsequently turns out to have been insolvent from the outset
- some insolvent companies could offer deeds of company arrangement that result in a better return for creditors than immediate liquidation: creditors should have the opportunity to consider such options
- it would remove the only alternative to liquidation for directors faced with a director penalty notice issued by the Australian Taxation Office under section 222AOE of the Income Tax Assessment Act, unless they pay the amount due or reach an agreement with the Commissioner
- in keeping with the objectives of VA (s 435A), that procedure should be available even if there is only a limited possibility of a successful restructuring.

Recommendation 4

The current prerequisites for entering into voluntary administration should be retained, including where the directors consider that 'the company is insolvent, or is likely to become insolvent at some future time'.

Reasons

The Advisory Committee is mindful of the desirability of encouraging companies to respond early to their financial difficulties. However, it does not appear that the current test of 'insolvent, or is likely to become insolvent at some future time' unduly inhibits directors in deciding whether to place the company into administration. For instance, directors may be able to take into account future as well as current circumstances in determining whether the company is 'likely to become insolvent' (*Crimmins v Glenview Home Units Pty Ltd* [2001] NSWSC 599¹). Any alternative formulation, such as 'may become insolvent', 'risk of insolvency' or 'financial difficulties', could be too open-ended. For instance:

- it may enable directors who are concerned that they may be removed by a resolution of shareholders to delay that process by taking advantage of the imprecision of any of the above alternative tests by putting the company into VA (though the legitimacy of any appointment of an administrator in these circumstances may be open to challenge (*Cadwallader v Bajco Pty Ltd* [2002] NSWCA 328))
- shareholders and unsecured creditors can be unduly disadvantaged if a company can enter into VA simply because it has encountered some financial difficulties (as both groups have their rights frozen).

Also, under the current formulation, it is unlikely that anyone could successfully challenge entry into a VA if the directors are acting in

¹ In that case, Palmer J said: 'The scope for forming an opinion of likely insolvency is very broad under s436A. For example, a director may legitimately form the view that insolvency is likely ten years hence because the company's business is founded on a particular technology that will be completely obsolete by that time and the company's business is already dwindling at such a rate that continuing liabilities will inevitably outstrip the company's ability to pay.'

good faith on relevant information available to them about their company's financial position.

VA is just one means by which a company can respond expeditiously to its financial difficulties. There are informal contractual arrangements that companies may seek to enter into if they are in financial difficulties, short of actual or likely insolvency.

A good faith only test would not be appropriate unless there was an extensive increase in the level of judicial supervision to test the basis for the application, as occurs under Chapter 11.

Any prohibition on an insolvent company appointing an administrator could create considerable uncertainties for directors contemplating a VA, given the great difficulty in some instances, particularly cases involving large and complex enterprises, in determining if the company is technically insolvent. Also, as pointed out in the submissions, a company that has a surplus of assets over liabilities but is cash flow insolvent may benefit from restructuring through a VA and a deed of company arrangement, particularly if the company's cash position has been adversely affected by unforeseen, temporary events.

Parliamentary Committee report

The PJC recommended that the threshold test for directors to appoint an administrator under VA be revised to alleviate perceptions that VA is only available to insolvent companies. It noted the suggestion that the test be reworded to read 'the company is insolvent or may become insolvent' (PJC report, para 5.52, Recommendation 14).

2.4 Persons entitled to appoint an administrator

[Discussion Paper paras 1.15–1.26 and 2.33–2.34]

The issue

Should anyone, in addition to those already entitled, have the power to appoint an administrator?

Currently, an administrator may be appointed by the board of directors, a liquidator or provisional liquidator or a secured creditor that has a charge over all or substantially all the property of a company (a substantial chargee).

Submissions

Retain current law

The submissions generally favoured no change to the current law, arguing that:

- it is consistent with sound corporate governance principles that the directors who have managed the company and who face personal liability if they allow the company to continue in business and engage in insolvent trading should retain the responsibility to place the company into VA
- the directors are best placed to decide if a company needs to go into VA.

Extend to individual creditors

Some respondents favoured individual creditors also having the right to appoint an administrator with the leave of the court. This may provide an appropriate warning of insolvency, while the requirement for court consent could prevent frivolous use of the right. However, one respondent observed that few, if any, rescue attempts are initiated by creditors in those jurisdictions where creditors have this right.

Other submissions opposed extending this right to creditors, arguing that:

- it would be very difficult for one creditor to judge whether it is in the interests of all creditors for the company to be placed into VA
- VA depends on at least the initial cooperation of directors
- creditors can already seek the appointment of a provisional liquidator, who would be better placed to determine whether a VA is appropriate

- creditors are rarely likely to have sufficient information to determine if the court should appoint an administrator.

It was also argued that the proposal could be abused if:

- dissident directors who were creditors or creditors who were related parties of those dissident directors made court applications, or
- it was used as a form of takeover mechanism through, for instance, an equity for debt swap, which could fundamentally undermine the value of existing shares for the benefit of the creditor taking up the equity.

Extend to individual directors, shareholders or ASIC

Most submissions did not support giving any of these parties the right to appoint an administrator with the leave of the court.

Recommendation 5

There should be no change to the existing law concerning who may appoint an administrator.

Note: this recommendation supersedes Recommendation 44 of the 1998 VA report, which proposed that individual creditors be permitted to appoint an administrator with the leave of the court.

Reasons

Entry into administration should remain at the discretion of the board of directors (as the directors remain at risk of personal liability under the insolvent trading provisions until such time as the company enters into VA) and the limited group of other parties who currently have that power.

Individual directors

Individual directors should not have the power to appoint an administrator. It is not appropriate to use VA as an alternative solution to, say, board dissension or deadlock. Its proper role is to deal with financial stress, not corporate governance stress.

Dissenting directors have various other remedies under the existing law, including seeking to have the company placed into provisional liquidation or wound up on the just and equitable ground or approaching ASIC with their concerns. ASIC has power under s 50 of the ASIC Act to commence proceedings in appropriate circumstances.

Creditors

Creditors should not have any additional rights to place a company in VA. The exception whereby substantial chargees can appoint an administrator was designed to give them an alternative to appointing a receiver. To give other creditors that right, or permit them to apply to the court, could compromise the fundamentally voluntary nature of VA. Individual creditors may have contractual remedies and can seek to have a company placed in liquidation.

Shareholders

Shareholders collectively should not have any power to pass a resolution that a company be put into VA, as:

- they may lack sufficient financial or other information (for instance, about confidential ongoing commercial negotiations) to make a fully informed decision
- they may not be aware of the implications of triggering a VA (for instance, in relation to set-offs, ipso facto clauses, Romalpa clauses, or the appointment of a receiver).

Individual shareholders who have serious concerns can:

- seek an oppression remedy or apply to have the company wound up
- initiate a shareholders' meeting to replace one or more directors, or
- approach ASIC.

Also, to give individual shareholders the right to place a company in VA would be contrary to the principles in *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 10 ACLR 395, whereby the rights of creditors are paramount when a company is at or near insolvency.

ASIC

There is no compelling case for giving ASIC the right to place a company into VA, given its various other powers to intervene in the affairs of a company.

2.5 Notifying pre-commencement creditors

[Discussion Paper paras 2.77–2.81]

The issue

Should administrators be permitted to use methods other than hard copy to distribute information to pre-commencement creditors?

Currently, administrators must send hard copies of all documents to these creditors unless the court permits some other means of disseminating information.

Submissions

Most submissions supported changes to the legislation to recognise the utility of modern electronic communication methods to inform creditors, such as websites and telephone hotlines. Respondents argued that it was inefficient and time-consuming to have to send all information in printed form by post, which could consume substantial funds that would otherwise be available for distribution to creditors. For instance, the Ansett administrators estimated it would cost approximately \$28 million to send the notice of the second meeting and accompanying documentation to the approximately four million creditors.

One suggestion was that creditors could be notified in writing of the time, place and date of a meeting and of the availability of supporting documentation on the identified website or by telephoning a toll free number. Court approval for use of these methods on each occasion should not be required. However, the needs of creditors situated outside Australia would need to be taken into account if this approach were adopted.

Recommendation 6

Administrators who wish to provide information to creditors other than in hard copy form should be required to send each notifiable creditor of a company an initial written notice that the company has gone into administration. The notice should indicate:

- where information regarding the holding of subsequent meetings, and documents for those meetings, can be obtained. At a minimum, the information sources identified in the written notice should be a toll-free telephone number to obtain written information free of charge and a designated website that will contain the information
- the statutory timeframes for holding further meetings and issuing information for those meetings.

Administrators who choose to provide this information should not be required to send creditors any further written information unless the creditors so request.

Note: This recommendation does not:

- affect the requirement in s 439A(3)(b) requiring newspaper notices
- apply in the context of pooling (see Recommendation 42).

Reasons

It is in the interests of creditors for administrators to use the most inexpensive and efficient means to provide them with information. In particular, the onus should be on creditors, once initially informed by written notice, to request further documentation (for instance, by use of the toll-free telephone number) or download it themselves from the administrator's website, rather than receiving it automatically. Making information available in this way should ensure that creditors can obtain the information at little or no cost to themselves. Overseas contactable creditors would not be unduly disadvantaged, given that they would receive the initial written notice and thereafter could access at least the website.

Parliamentary Committee report

The PJC recommended that the Government consider making technology and e-commerce options more widely available to

enhance communication with stakeholders in external administrations and reduce the costs of external administrations (PJC report, para 6.93, Recommendation 20).

2.6 Timing of first and major meetings

[Discussion Paper paras 1.65–1.68 and 2.61–2.73]

The issue

Should there be any amendment to the current provisions regulating the timing of first and major meetings?

Currently, the first meeting must be held within 5 business days, and the major meeting generally within 21 days, of the appointment of the administrator.

Submissions

One view was that the existing time limits for the first and major meetings, while appropriate for small and medium enterprises, are clearly inadequate for large and complex enterprises. The need for regular court applications for extensions of time leaves the administrator, the company and the creditors uncertain about how much time will be available. One possibility was to allow a longer convening period, say an extra 60 days, for large and complex enterprises (defined on the basis of a threshold asset, liability or turnover test of the entity), while retaining the current right of creditors to adjourn the major meeting for a period of up to a further 60 days.

However, most submissions considered that the current VA time limits (possibly with some incremental changes, such as suggested in the 1998 VA report) are sufficiently flexible to adjust to the needs of particular companies, including large and complex enterprises, as:

- the court, on the application of the administrator, may use its general discretionary power under s 447A to adjust these time limits
- the court can take into account relevant considerations concerning the progress of the rehabilitation and its impact on

creditors in deciding whether, or on what terms, to grant any time extensions, as in the Ansett and Pasmenco administrations

- the current timeframes create an appropriate incentive for creditors to agree on a course of action, particularly where a company is heading for insolvency. By contrast, the rights of creditors could be detrimentally affected if time periods were too greatly extended
- the longer an administration lasts, the less surplus may be available for shareholders and employee entitlements and the more competitors' market position and suppliers' finances may be detrimentally affected.

Furthermore, any lengthening of time periods could reduce the responsibility of management and the board to be on top of the company's business situation at all times.

On a technical point, one respondent suggested that the provision for adjourning the major meeting should be changed to provide that the meeting may be adjourned for up to 60 days, rather than the current 'cannot be adjourned to a day that is more than 60 days after the first day that the meeting is held' (s 439B(2)), which the respondent suggests may require adjournment to a particular day. The suggested change would give the administrator a period within which the meeting must be reconvened.

Recommendation 7

As recommended in the 1998 VA report:

- the periods for holding the first and major meetings of creditors should be incrementally increased (namely, for the first meeting within 8 business days, and for the major meeting within 25 business days, of the appointment of the administrator), and
- the administrator should be permitted to hold the major meeting before the end of the convening period.

In addition, the court should have a specific power, on application by the administrator, to override the statutory timetable and to substitute a specific and comprehensive timetable for a particular administration.

Administrators should have the power to adjourn a creditors' meeting either to a specific date or a date to be notified within the specified statutory period.

Reasons

There should be sufficient flexibility in a timetable to accommodate large and complex enterprises. This goal would be promoted by adopting the incremental timing changes recommended in the 1998 VA report, Recommendations 2 and 6. This would be preferable to varying the timing requirements according to an assets, liabilities or turnover test, which would be arbitrary and could result in administrations of comparable companies having different convening periods, depending on whether they fell just above or below any stipulated threshold.

The court's additional power to replace the statutory timetable would, in appropriate cases, assist in settling a timetable that is appropriate for the particular circumstances of a complex VA. This may give greater timing certainty in large and complex enterprise administrations.

Parliamentary Committee report

The PJC recommended that the first meeting be held within 8 business days after the beginning of the administration, with a requirement of 5 business days' notice of the meeting to creditors (PJC report, para 6.24, Recommendation 15).

The period for holding the major meeting of creditors should be extended to 25 business days, with a new convening period of 20 business days (PJC report, para 6.37, Recommendation 16).

These recommendations to extend incrementally the period for holding the two meetings adopt the recommendations in the Advisory Committee's 1998 VA report.

The additional proposal in Recommendation 16 of the PJC report that the adjournment period should remain at 60 days contrasts with Recommendation 9 of the 1998 VA report that:

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.

2.7 Powers of creditors at first meeting

2.7.1 Extend convening period for major meeting

[Discussion Paper paras 2.74–2.75]

The issue

Should the creditors at the first meeting be given the power to extend the convening period for the major meeting of creditors?

Submissions

Several submissions favoured giving creditors this power, subject to a maximum extension period, with the administrator applying to the court for any further extension. Some respondents said that a maximum period would ‘allow for the proper recognition of assets and liabilities in the financial statements’.

Other submissions opposed this option, arguing that:

- in large corporate collapses, the administrators, let alone the creditors, may have little initial understanding of the extent of the company’s financial difficulties and could not make an informed decision on this matter at the first meeting
- the creditors at the first meeting may not be representative of the full body of creditors, given the short time for calling that meeting
- it could result in administrations continuing longer than necessary, with the creditors lacking important information for an extended period.

Recommendation 8

Creditors at the first meeting should not be given the power to extend the convening period for holding the major meeting.

Reasons

The creditors who attend the first meeting may not always be representative of creditors as a whole because of the practical difficulty of identifying and informing all creditors within the short period before the meeting, and the inability of some creditors to attend on such short notice. In those circumstances, it is not appropriate for them to have the power to prolong the VA procedure, including the moratorium, by postponing the major meeting.

2.7.2 Winding up the company

[Discussion Paper paras 2.75–2.76]

The issue

Should the creditors at the first meeting be given the power to wind up the company?

Submissions

Various submissions supported the first meeting of creditors having the power, with the administrator's consent, to place a company into liquidation and to choose the liquidator. It was argued that this would:

- result in a better return to creditors by avoiding the cost of holding two meetings when it is obvious to the administrator that liquidation is the only alternative
- provide a fast and efficient means of creditors' voluntary liquidation
- give directors a viable choice when served with a s 222AOE notice from the Australian Taxation Office.

A contrary view was that there may not be a representative sample of creditors, particularly major creditors, at the first meeting, given

the short notice period. Also, the information available to creditors at that time may be very limited or imprecise, given that the administration has just commenced.

Recommendation 9

Creditors at the first meeting should not be given the power to wind up the company.

Reasons

It would be unusual for creditors at the first meeting to have sufficient information to reach an informed decision.

2.8 Voting at creditors' meetings

[Discussion Paper paras 2.101–2.111]

The issue

Should there be any changes to the current voting arrangements?

Currently:

- a resolution of creditors requires the support of a majority by number, as well as by value, of creditors
- administrators have a casting vote where there is a deadlock between a majority in number and value of creditors.

Creditors can challenge the exercise of the casting vote in court.

Submissions

Submissions proposed a variety of voting procedures or further requirements.

Many submissions broadly supported a continuation of the current law. Although those with the largest debts generally have the most at stake, it would be improper to allow them automatically to override the majority in number, which could undermine the community's perception and acceptance of VA. The administrator must exercise

any casting vote in what he or she perceives to be the overall best interests of the company.

A contrary view favoured voting being by majority in value only, thereby avoiding the need for any casting vote. However, one suggestion was that the administrator should have a right to veto a resolution that has been passed by a majority in value where creditors who were related parties of directors voted as directed by the directors. A variation of this was that related parties be prohibited from voting, except with leave of the court.

Some other respondents proposed:

- adopting the voting requirements for schemes of arrangement, namely, 50% of creditors by number and 75% by value, as, in large and complex enterprise administrations, there are likely to be a vast number of creditors with low value claims, who can skew voting patterns so that they do not fully reflect the value of debt in the balance sheet and the real financial position of the company
- retaining the administrator's casting vote to resolve any deadlock between creditors by value and creditors by number, subject to the administrator being obliged to make proper inquiries (for instance, an independent report from a financial expert, such as the company's auditor) or obtain appropriate legal advice about the implications of the vote, at least in a large and complex administration.

Some submissions suggested that, in the interests of accountability, administrators should be required to give reasons for the manner in which any casting vote is exercised.

Another respondent proposed that:

- administrators be prohibited from using their casting vote in any resolution in which they have a direct interest (for instance, resolutions regarding their removal or remuneration), given the importance of the administrator's independence
- the administrator in those circumstances, or any creditor, should have the power to request the court to resolve any consequential creditor deadlock.

Some submissions suggested giving a casting vote to an independent chairperson, third party expert or arbitrator, rather than the administrator, depending on the circumstances in any particular case.

Recommendation 10

Voting in voluntary administrations should continue to be according to majority by value and majority by number of creditors.

Administrators should retain the right to exercise a casting vote in the event of deadlock of a vote by value and a vote by number of creditors. They should not be required to obtain an independent report before exercising their casting votes. However, within a prescribed period they should be required to publish reasons for the way they exercise any casting votes.

Reasons

Current practice

There is no evidence of widespread abuse of the current voting system, which gives the administrator a casting vote to break any deadlock between number and value of creditors. Also, individual creditors can seek to have a creditors' meeting adjourned in an attempt to resolve any deadlock and avoid the need for the administrator to exercise a casting vote.

No viable alternative

Any alternative to the current system giving administrators a casting vote would have significant practical problems. For instance, permitting resolutions to be carried by the votes of a majority in value only could create scope for abuse by these creditors structuring deeds to benefit themselves over other creditors. Alternatively, requiring the court to resolve all deadlocks, or those relating to an administrator's remuneration or removal from office, could be unduly expensive or time-consuming and could involve the court in commercial decision making.

Dealing with self-interest

On one view, permitting administrators to exercise a casting vote on any resolutions involving their remuneration or removal from office raises the possibility of self-interest. However, the Committee does

not support excluding the administrator's casting vote for these resolutions, as:

- it may be difficult to identify clearly all the transactions that could affect an administrator's remuneration. Many proposals that go to creditors may indirectly affect the remuneration of administrators
- the recommendation elsewhere in this report to tighten the criteria for who can be an administrator may reduce the chances of inappropriate persons acting as administrators and abusing any casting vote power
- administrators remain fully accountable to the court under the existing appeal and review mechanisms
- the Advisory Committee's recommendation that administrators should be required to give reasons for exercising any casting vote may reduce the possibility of abuse
- dissenting creditors can exercise their statutory right to apply to the court to remove an administrator or review his or her remuneration.

Any requirement that an administrator obtain an independent report before exercising a casting vote could be costly and time-consuming. Also, the person preparing that report would merely replicate the administrator's existing duties to make proper inquiries.

Publishing reasons

Administrators should be required to publish reasons for the way they exercise any casting vote, as:

- it would reinforce the need for administrators carefully and deliberately to consider their reasons for any casting vote
- the reasons may provide grounds, in any appeal, for determining whether the administrator was biased, took into account irrelevant considerations, failed to take into account relevant considerations or lacked any reasonable grounds for a decision. The court would not be required to review the commerciality of the reasons given.

Requiring administrators to give reasons could act as a significant discipline on administrators, while assisting dissidents in any court appeal.

Parliamentary Committee report

The PJC recommended that an administrator should be prohibited from using a casting vote in a resolution concerning his or her remuneration (PJC report, para 7.25, Recommendation 25) or removal from office (PJC report, para 3.73, Recommendation 3).

2.9 Ambit of the court's powers to give directions

[Discussion Paper paras 2.161–2.167]

The issue

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

Currently, the courts have a broad discretionary power to give directions, but have indicated that they will not do so merely to approve an administrator's business or commercial proposals.

Submissions

The submissions generally supported the current law, arguing that:

- the court's current discretionary powers to supervise administrations (including its power to approve an administrator's actions in appropriate cases and protect them against subsequent allegations of breach of duty) (ss 447A, 447D) are sufficiently clear and appropriate
- administrators have the same responsibility for business decisions as company management. Administrators are officers of the company and are subject to the same duties as other officers. It is not the appropriate role of the court to make commercial decisions on behalf of, or at the request of, these persons

- any move to permit administrators to delegate their business judgment to the court would unduly increase the time and cost of administrations.

Recommendation 11

There should be no change to the court's current discretionary powers concerning VAs.

Reasons

The court's current powers to give directions on legal questions are adequate and are working appropriately. VA is primarily a non-judicial procedure. The court's current powers are auxiliary only. Any specific extension of its powers to cover business or commercial matters may fundamentally change the nature of the procedure and require the court to make decisions on matters outside its appropriate judicial decision-making role.

2.10 Time for making draft deed available to creditors

The issue

Should there be some statutory timeframe for forwarding the draft deed to creditors before the major meeting?

Submission

One respondent recommended that a draft deed be sent or made available for inspection at least 5 days prior to the major meeting.

Recommendation 12

There should be no statutory timeframe for forwarding the draft deed to creditors before the major meeting.

Reasons

Currently, an administrator must forward to creditors in advance of the major meeting a statement setting out the details of any proposed

deed. A further requirement as proposed by the respondent would be impractical. In certain cases, the principal purpose of the major meeting may be to determine whether to proceed by way of deed of company arrangement or liquidate the company. It may be premature to prepare and circulate a detailed draft deed before this matter is settled. In other circumstances, creditors at the major meeting may have to make various decisions before the terms of any proposed deed can be drafted. Rather, Recommendations 11 and 12 of the 1998 VA report are designed to ensure that creditors have an appropriate opportunity to consider the details of the draft deed, once it has been prepared.

2.11 Solvency under the deed

[Discussion Paper paras 2.222–2.223]

The issue

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

Submissions

Some submissions supported a requirement of solvency at the time that the company enters into a deed of company arrangement, arguing that this requirement would:

- reduce the incidence of ‘phoenix’ companies, and
- be consistent with the principle of encouraging companies to take early remedial action before they become insolvent.

Other respondents opposed this requirement as being unnecessary or unworkable.

Recommendation 13

There should be no solvency prerequisite for a valid deed of company arrangement.

Reasons

It can be very difficult to determine at any particular time, including when a deed is entered into, whether a company is solvent. Also, the validity of a deed may be in doubt if a company whose directors considered it was solvent at the time of entering into the deed later turned out to have been insolvent at that time.

2.12 Time to implement a reconstruction plan

[Discussion Paper paras 1.69–1.70]

The issue

Should there be any legislative limit on the period during which a deed can remain in force?

Submissions

Submissions generally did not support the UK approach of stipulating an implementation timeframe. Respondents argued that any arbitrary time limits during the implementation phase of any plan may not be conducive to rehabilitating particular large and complex enterprises. It should be left to creditors, when voting for a deed of company arrangement, to decide whether to approve any timeframe set down by the proposed deed.

Recommendation 14

There should be no legislative limit on the period during which a deed can remain in force.

Reasons

The appropriate period for operation of a deed is a matter for creditors. Any statutory time limit would be arbitrary and may unduly limit the ability of creditors to agree on a period that best suits the company's circumstances. For instance, administrations such as those of Ansett or Pasminco can take years to complete.

A shareholder may have standing to apply under s 445D as an 'interested person' to have a deed terminated where that deed substantially affects the shareholder's material rights or economic interests. An example might be where the rights of shareholders will remain frozen for an extended period under a long-term deed, notwithstanding that the company's financial position has materially improved.

3 Administrators and deed administrators

Who should be permitted to conduct a voluntary administration and what should be their obligations, rights and powers in carrying out their statutory duties?

3.1 Qualifications to be an administrator

[Discussion Paper paras 2.35–2.38]

The issues

Should there be any changes to the current criteria that permit only registered liquidators to act as administrators or deed administrators?

Should there be any restrictions on the classes of administrators who may act as administrators of large and complex enterprises?

Should there be a roster system for the appointment of administrators of large and complex enterprises?

Submissions

Current criteria

Some respondents were critical of the current criteria under which only registered liquidators can act as administrators. The criteria should be expanded to include other persons with relevant expertise.

Administrators of large and complex enterprises

One view was that only senior practitioners with the requisite skills, education, experience and expertise should be permitted to manage large and complex administrations.

Other submissions opposed any separate qualifications for administrators of large and complex enterprises, or requiring the

court to approve the appointment of an administrator of these enterprises, arguing that:

- it would be unnecessary if tighter eligibility standards to be an administrator were developed by ASIC having regard to competency criteria including experience and educational qualifications
- the current approach is to make court involvement in VA the exception, not the norm
- court involvement at this stage is unnecessary, as creditors can review the administrator's appointment at the first meeting.

Roster system

The submissions were divided on whether there was any need for a roster system to improve the perception of administrators' impartiality and independence. On one view, a roster system could avoid any suggestion of collusion between the appointing directors and the administrator. The contrary view was that this system would not necessarily result in the appointment of the most appropriate person for the circumstances of the particular company in VA. This matter should be left to the board of directors.

Recommendation 15

Persons with adequate expertise and experience in corporate rehabilitation (whether or not they also have expertise and experience in liquidations) should be permitted to be administrators.

There should be no roster system for the appointment of administrators.

The court, on application by an eligible appointor, should have the power to appoint as administrator of a particular company a person who does not satisfy the eligibility criteria, if satisfied that the person's specific skills and experience are especially relevant to the activities of that company.

Reasons

Criteria to be an administrator

Administrators should have appropriate expertise and experience in dealing with corporate rehabilitation, not just windings up. This can be achieved by:

- *narrowing* the criteria for being an administrator by not permitting persons to so act merely because they are registered liquidators, but requiring in addition that these liquidators have adequate corporate recovery experience
- *widening* the criteria for being an administrator by including legal practitioners or other experts with adequate corporate rehabilitation experience
- *empowering* the court to permit other persons to act as administrators where they have skills that are peculiarly appropriate for particular cases.

There may be various ways to implement this policy, for instance:

- separately licensing administrators and liquidators, with each form of licence reflecting the skills required to carry out that function, or
- creating sub-categories of licensed liquidators.

No roster system

The directors, or other persons entitled to appoint administrators, should continue to be free to choose administrators from the class of licensed administrators (with creditors continuing to have the right to replace the initial appointee at the first meeting). Likewise, the Harmer Report rejected a roster system for appointing administrators, arguing that:

A roster system would detract from the voluntary nature of the procedure. The quality of administrators would inevitably vary from person to person. The directors may have proposals for dealing with the company's insolvency. In fact, the existence of those proposals may have encouraged the directors to have the company voluntarily submit its affairs to a particular insolvency administrator. Therefore

it is important that the company, at least in the initial stages, should have some freedom of choice in appointing the administrator.²

Parliamentary Committee report

The PJC recommended that the criteria for registration as an insolvency practitioner be broadened to recognise qualifications in other relevant disciplines including legal practice (PJC report, para 3.96, Recommendation 5).

The PJC did not consider that a roster or rotation system should be adopted as the main method of appointment of administrators (PJC report, paras 3.47–3.53).

3.2 Lodgement of notification of appointment/cessation of administrator

[Discussion Paper para 2.236]

The issue

Should the time for an administrator to lodge a notice of appointment/cessation differ depending on whether the company is or is not large and complex?

Currently, administrators have 24 hours to lodge these notices.

Submissions

Respondents did not favour differentiating between large and small administrations for the completion and lodgement of these forms. In all cases, notification of the appointment should be given as soon as possible.

Recommendation 16

The current time within which administrators must lodge notification of appointment or cessation (24 hours) should remain.

² Australian Law Reform Commission Report *General Insolvency Inquiry* Report (1988) (ALRC 45), vol 1, para 70.

Reasons

The current notification requirement should remain for all companies in VA. In this context, the size or complexity of the administration is irrelevant to the time needed by administrators to lodge notification of their appointment or cessation.

3.3 Administrator's access to information gathered by regulators

[Discussion Paper paras 2.173–2.175]

The issue

Should there be any change to the current circumstances in which administrators can receive information from ASIC?

Currently, ASIC may under ss 25 and 127 of the ASIC Act provide information to various parties where appropriate.

Submissions

Respondents supported ASIC providing information to administrators to assist them in litigious proceedings contemplated in good faith or in complying with an obligation to investigate and report on the affairs of a company.

Recommendation 17

There should be no change to the current law regarding the circumstances in which ASIC may provide information to administrators.

Reasons

It is beneficial if ASIC can give administrators information to assist them to perform their functions. However, there is no compelling case for going beyond the current statutory powers permitting ASIC to provide this information where appropriate.

3.4 Remuneration of administrator

[Discussion Paper paras 2.112–2.120]

The issue

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

Currently, only the major meeting of creditors, or the court, can determine the administrator's remuneration.

Submissions

Various submissions supported Recommendation 38 of the 1998 VA report, which recommended that in addition to the current remuneration approval powers, administrators be able to obtain approval of their fees by:

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

In relation to these two proposed additional methods, some respondents to the current review supported the relevant creditors receiving at least seven days' prior written notice of the amount of the remuneration claimed, together with details of how the amount claimed is comprised and calculated. Some submissions also favoured a requirement for a report on work undertaken to be provided with every request for fee approval. Arguably, this would give creditors an understanding of the ongoing costs.

Some respondents suggested that best practice might be for fee agreements to be made in two stages:

- an initial fee agreement between the administrator and the committee of creditors that would govern the period up until the major meeting of creditors

- a subsequent fee agreement at the major meeting between the administrator and the creditors.

It was suggested that the procedures for approving the administrator's remuneration should also apply to fees incurred during any subsequent deed or liquidation, provided that proper notice and disclosure is given. This would remove the pressure on administrators to estimate the costs of finalising the administration before the major meeting.

Recommendation 18

Administrators' remuneration should be able to be approved by:

- agreement between the administrator and a simple majority, by value, of the committee of creditors, or
- resolution of creditors generally (in accordance with the voting procedure in Corporations Regulations regs 5.6.19 and 5.6.21) where they have notice that this matter is to be considered, or
- the court.

Any approval by the committee of creditors should be effective only until the major meeting or any other general meeting of creditors. Creditors at a general meeting could prospectively, but not retrospectively, amend any remuneration agreement approved by the committee of creditors.

Reasons

This recommendation is a development of Recommendation 38 in the 1998 VA report.

Permitting the committee of creditors to approve interim remuneration can overcome the considerable delay that may arise, particularly in large and complex administrations, from either having to wait until the major meeting of creditors or having to call an extraordinary general meeting of creditors.

The Advisory Committee does not favour requiring administrators to give seven days' written notice of a fees proposal or having to send a work in progress report with any such proposal. It is open to creditors who consider that they have not received sufficient notice to vote against any remuneration proposal. Also, creditors can

choose to require a work in progress report before approving remuneration.

3.5 Assigning or terminating executory contracts

[Discussion Paper paras 2.207–2.211]

The issue

Should administrators be given the power unilaterally to assign or terminate ongoing contracts that the company entered into prior to the administration, subject to appropriate safeguards or remedies for the counterparty?

Submissions

Unilateral assignment

One respondent supported the administrator having a unilateral assignment power, with the contractual counterparty having the right to object to the court if:

- the proposed assignee is less creditworthy than the debtor company was at the time of entering into the contract, or
- reasonable assurances of payment have not been provided.

Other submissions opposed the administrator having this unilateral power, arguing that it would interfere with fundamental contractual rights. Any assignment should only be in accordance with the terms of the contract or with the prior consent of the contractual counterparty.

Termination

One respondent favoured the administrator having a termination power, regardless of the contractual terms, with the counterparty having remedies in damages against the company.

Other submissions argued that any termination should only be in accordance with the terms of the contract or with the prior consent of the contractual counterparty. Those respondents pointed out that an administrator's role is different from that of a liquidator, whose

termination powers arise from the liquidator's obligation to wind up the company, including terminating its business and future obligations.

Recommendation 19

Administrators should not be given the power unilaterally to assign or terminate contracts.

Reasons

There is not a sufficiently strong case for giving administrators a power to interfere unilaterally with the terms of contracts. On the one hand, this power might assist administrators in continuing or restoring the company as a going concern. However, it would reduce certainty for counterparties and increase the commercial risks to them. They would be forced to litigation if they were not satisfied with the administrator's action.

3.6 Voiding antecedent transactions

[Discussion Paper paras 2.127–2.133]

The issue

Should an administrator or a deed administrator be given the right to apply to the court to void antecedent transactions?

Submissions

Submissions generally considered that an administrator or deed administrator should not be given this right, arguing that:

- the timeframe for a VA is generally too short to pursue antecedent transactions
- to confer this right would result in VAs becoming quasi-liquidations, defeating their purpose
- the voiding of antecedent transactions is inherently related to liquidation.

However, one submission considered it appropriate to allow creditors to approve a deed that confers on the deed administrator the capacity to pursue antecedent transactions, provided that Part 5.7B (Recovering property or compensation for the benefit of creditors of insolvent company) is included in its entirety, to avoid the possibility that, for example, creditors could be exposed to liability for preferences or uncommercial transactions, while directors are protected from actions for insolvent trading.

Recommendation 20

Administrators and deed administrators should not be given the right to void antecedent transactions.

Reasons

The right to avoid antecedent transactions is properly confined to liquidations. It should not be extended to other forms of external administration.

3.7 Power to issue equity

[Discussion Paper paras 1.62–1.63]

The issue

Should there be a specific statutory provision permitting administrators or deed administrators to issue new shares in the company in administration?

Currently, an administrator has the power to ‘perform any function, and exercise any power, that the company or any of its officers could perform or exercise if the company were not under administration’ (s 437A(1)(d)). Arguably, on the basis of this power, an administrator could issue new shares in the company, subject to any limitations in the company’s constitution (including, for instance, class rights) and general law restrictions such as the prohibition on issuing shares for improper purposes. Also, any existing dissenting shareholder could seek an oppression remedy or a remedy under s 447E(1). Furthermore, any listed company in VA remains subject to the ASX requirements, including Listing Rule 7.1, which requires

shareholder approval of any proposal to issue new capital in excess of 15% of the current capital.

Submissions

No submissions commented on the matters raised in paras 1.62–1.63 of the Discussion Paper.

Recommendation 21

There is no need for a specific provision empowering an administrator or deed administrator to issue shares in a company under administration.

Reasons

The current law appears to deal adequately with this matter. No respondent proposed that new equity holders be given additional rights as an incentive to take up new shares.

3.8 Power to sell or cancel equity

The issue

Should deed administrators have a unilateral power to sell or cancel existing shares in a company that is subject to a deed of company arrangement?

Prior to execution of a deed, the administrator cannot sell or cancel shares (s 437F).

Under the prescribed provisions (which are incorporated in a deed unless expressly excluded), a deed administrator has the power ‘to enter into and complete any contract for the sale of shares in the company’ (Corp Reg 5.3A.06, Schedule 8A, cl 2(zc), s 444A(5)). However, it is unclear whether a deed administrator can sell shares in the company without the consent of the shareholder.³

³ GJ Hamilton, “Deeds of Company Arrangement: The Prescribed Provisions” (1995) 3 *Insolvency Law Journal* 67 at 75.

The legislation provides no guidance on whether creditors can approve a deed that contains a provision giving the deed administrator unilateral power to cancel shares.

Submissions

One respondent favoured deed administrators having a unilateral power to sell or cancel shares, arguing that their current inability to do so may effectively require them to sell business assets rather than offer existing equity to a creditor. This inflexibility may result in:

- increased stamp duty costs, and
- in the case of the restructuring of an ASX-listed entity, an inability to realise full value from the entity's listed status.

That respondent also pointed out that a unilateral power of this nature would have the added benefit of enabling the deed administrator to crystallise a capital loss, which may attract a tax benefit for existing shareholders.

Recommendation 22

Deed administrators should have the power to sell or cancel existing shares in the company only with the approval of the shareholder or the leave of the court. Shareholders, creditors and ASIC should have standing to oppose a court application for leave.

Reasons

The 1998 VA report (Recommendation 42) proposed that deed administrators be permitted to sell shares, though only with the prior approval of the holder (voluntary transactions) or with the leave of the court.

The Advisory Committee reviewed this recommendation in response to the submission mentioned above that deed administrators should have a unilateral power to sell or cancel shares. The Advisory Committee confirms its earlier recommendation that, other than for voluntary transactions, deed administrators may sell shares only with the leave of the court. The same principle should apply to cancelling shares.

The arguments for giving deed administrators a unilateral power, either at their own volition or pursuant to a deed of company arrangement, include that it would enable them to reorganise the share capital base of a company in VA, rather than, say, sell its assets to a new company and have the VA company put into liquidation.

However, deed administrators could use a unilateral power to change fundamentally the control arrangements within a company, to the detriment of existing shareholders. For instance, a deed administrator could in effect hand control of a company to a creditor by compulsorily cancelling existing shares and issuing new equity to that creditor. The 1998 VA report also pointed to the possibility of shares being compulsorily transferred to creditors at an undervalue. The onus should not be on affected shareholders to mount a court challenge in these circumstances.

The recommendation overcomes uncertainties in the existing law, while avoiding possible abuse by requiring that any compulsory sale or cancellation be approved by the court. A deed administrator could in an appropriate case seek leave to exercise that power. In considering an application, the court could take into account the reasons for the proposed mandatory sale or cancellation and whether the interests of shareholders have been appropriately taken into account, in particular whether the shares have or are likely to have any value.

4 Creditor moratorium

How should the interests of secured creditors, creditors with set-off rights and beneficiaries of ipso facto and Romalpa clauses be treated during an administration?

4.1 Substantial chargees

4.1.1 Right to appoint a receiver

[Discussion Paper paras 1.43, 1.47–1.52 and 2.42–2.52]

The issue

Should a creditor with a charge over the whole or substantially the whole of a company's property (a substantial chargee) continue to have the right to appoint a receiver, or itself enter into possession, of that property (both methods of enforcement hereafter referred to as appointing a receiver) after the appointment of an administrator?

Currently, under s 441A, a substantial chargee may exercise the right to appoint a receiver within 10 business days of being notified of the administrator's appointment. By contrast, UK legislation that came into effect in September 2003 prohibits substantial chargees in that jurisdiction from appointing a receiver for most charges entered into after that date either before or after the appointment of an administrator.

Submissions

Introduce new restraints on substantial chargees

Several submissions supported introducing limitations, along the lines of the UK legislation, on the rights of substantial chargees to stand outside an administration, arguing that:

- the debts owed to substantial chargees would usually swamp those owed to other creditors, so that any successful

restructuring could not take place without the support of the substantial chargees. Therefore, substantial chargees do not need an additional power to appoint a receiver

- the extent of the current carve-out for substantial chargees is unclear, given the ongoing uncertainty about the meaning of ‘substantially the whole’ of a company’s property in s 441A (is it ‘effectively 100%’, ‘51%’ or something in between)
- secured creditors may take featherweight charges (being lower ranking floating charges over the whole or substantially the whole of a company’s property) with a view to obtaining the protection of s 441A. The company is therefore needlessly restricted in its ability to raise further debt financing
- under the current Australian law, a substantial chargee can force a sale of the corporate assets, even where delay would result in a higher price, given that s 420A only requires a receiver to obtain a price that is ‘not less than [the property’s] market value or otherwise the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold’.

Retain current position

Various respondents supported the current position, arguing that:

- certainty about the rights of substantial chargees may ensure that businesses generally receive continuing finance on current market terms and conditions
- it provides a sensible balance by allowing a substantial chargee a reasonable period to appoint a receiver, but thereafter letting administrators perform their duties unimpeded by a receiver
- the substantial chargee is likely to be the company’s major financier, and is more likely than a new financier to provide further financing
- substantial chargees usually refrain from appointing a receiver to a company under administration (especially as substantial chargees need not indemnify an administrator, but do indemnify receivers), unless there are good reasons, for instance, they have insufficient security, and/or are unhappy with the company’s choice of administrator, and/or disagree with the administrator’s

decisions. These issues are usually overcome by consultation with the substantial chargee before and throughout the administration

- the substantial chargee can decline to appoint a receiver, remove the receiver or otherwise limit the receiver's powers, to allow a restructuring plan formulated by the administrator and supported by the substantial chargee to take effect
- the factors that led to the introduction of the UK amendments, as set out in para 1.49 of the Advisory Committee's Discussion Paper, do not currently apply in Australia
- the UK approach could prove counterproductive if it increases the costs or limits the availability of debt funding, particularly for those companies already at greater risk of defaulting
- banks, as prudentially supervised institutions, have the responsibility to manage their assets in the interests of their depositors and more broadly their shareholders. Any weakening of banks' rights to enforce their securities might:
 - change the amount and the terms and conditions of corporate finance
 - affect the flexibility of banks' decision making about the company
 - encourage the financier to appoint a receiver on the occurrence of an event of default before the company has the right to appoint an administrator
 - cause the Australian Prudential Regulation Authority to impose higher capital requirements on banks, thereby affecting the cost of finance to the business community, and
 - detrimentally affect asset securitisation programs and investors' interests in securitised assets.

Recommendation 23

There should be no change to the current position under which a substantial chargee can appoint a receiver after receiving notification of the appointment of an administrator.

Reasons

From one perspective, once a company has gone into administration, all its creditors should be subject to a moratorium, thereby automatically suspending the right of a substantial chargee to appoint a receiver while the company remains in administration. The rights of the substantial chargee are protected, given that:

- during the moratorium period, the substantial chargee can influence the decision-making process through its voting power
- these rights revive if the substantial chargee does not voluntarily agree to a further suspension under the deed of company arrangement or if the company otherwise ceases to be under administration.

Further arguments for a general moratorium are:

- in some cases, a bank or other lender may have become a substantial chargee merely because it provided the original funding to set up the business. This raises the question whether it is reasonable that other creditors have lesser rights in a VA simply because they became creditors during the running of the business rather than at its inception. Rather, all creditors should have the opportunity to meet and seek a solution to the company's predicament
- the directors of some companies in financial distress may be reluctant to acknowledge this problem to their creditors out of concern that this may result in creditors appointing a receiver or otherwise acting to the disadvantage of the company.

The contrary argument is that the moratorium issue has to be considered in the broader context of corporate financing. To exclude the right of substantial chargees to appoint a receiver may impose additional financing costs on solvent companies that may never go into VA. Also, directors should at the time of entering into financing

contracts consider the implications of their terms, including what will happen if the company subsequently goes into VA. Furthermore, the long-term implications of the recent UK changes are unknown, given that the prohibition on substantial charges appointing a receiver only applies to charges created after the commencement of the legislation in September 2003.

On balance, the benefit of extending the moratorium to substantial charges is outweighed by the possible wider economic disadvantages of changing the law to restrict their right to appoint receivers.

Parliamentary Committee report

The PJC considered that a substantial chargee should continue to be able to enforce its security, by appointing a receiver, within the decision period (PJC report, paras 6.45–6.48).

4.1.2 Period to appoint a receiver

[Discussion Paper paras 2.53–2.54]

The issue

Should the current period within which the substantial chargee must decide whether to appoint a receiver (namely, 10 business days after being notified of the administrator's appointment) be extended or otherwise altered?

Submissions

Extending the statutory decision period

Some respondents supported extending the 10 business day decision period to, say, 15 business days. Arguably, this would provide a better opportunity for the chargee and the administrator to assess the future prospects of the company and the relative effects that an administration and a receivership would have on the assets covered by the security.

Postponing commencement of that period

One proposal was to retain a 10 business day decision period, but postpone commencement of that period for some unspecified time,

to allow all parties more opportunity to consider if there is any real prospect of the company being able to recover, and to renegotiate finance arrangements for this purpose.

Time extension agreements

Another submission was that the legislation should specifically permit the administrator, during the statutory decision period, to give written consent to the substantial chargee enforcing its charge after the decision period has expired. It was suggested that this would give a substantial chargee greater freedom to determine the timing of any realisation of secured assets in managing its exposure risk. This may give the chargee sufficient reassurance to stop it from pre-emptively enforcing its charge over company assets.

Recommendation 24

The decision period for substantial chargees to appoint a receiver after receiving notice of the appointment of an administrator should be increased to 15 business days.

An administrator should be permitted to enter into an agreement with the substantial chargee within that decision period whereby the substantial chargee may appoint a receiver at any time during the administration, provided the committee of creditors (by simple majority by value excluding any vote by the substantial chargee) has granted that power to the administrator.

Reasons

Incremental increase in statutory decision period

An incremental increase of 5 business days in a substantial chargee's decision period would give the administrator and the chargee more time to obtain and consider relevant information before the chargee has to determine whether to enforce the charge. It would also allow more time for the committee of creditors to consider whether to approve a voluntary extension agreement between the substantial chargee and the administrator.

The suggested alternative of postponing commencement of the decision period could needlessly delay a substantial chargee who has decided at the outset to appoint a receiver.

Time extension agreements

It is uncertain whether time extension agreements are permissible under the current law.

On the one hand, s 441A(1) requires a substantial chargee to decide 'before or during the decision period' (currently being 10 business days from notification to the chargee of the administrator's appointment) whether to enforce the charge, including by appointing a receiver. On the other hand, s 440B(a) permits a person to enforce a charge 'during the administration of a company' with the administrator's written consent. Views differ on which of these two provisions prevails over the other. There is no case law on this matter.

There are competing considerations about whether, in principle, time extension agreements should be permitted.

On one view, such agreements:

- could indefinitely extend uncertainty about whether a substantial chargee will, in effect, bring an administration to an end by appointing a receiver
- may result in substantial chargees requiring these voluntary agreements as a matter of course, thereby, in effect, rendering the statutory decision period meaningless.

However, on balance, voluntary agreements should be permitted, as:

- those agreements may enhance the likelihood of VAs proceeding, by encouraging the substantial chargee to refrain from appointing a receiver (which in most instances would undermine any chance of corporate recovery) for sufficient time to enable the administrator to determine whether a recovery is possible
- without the possibility of these agreements, some substantial chargees may consider that they have no option but to appoint a receiver in the initial decision period
- in some cases, a substantial chargee may be owed virtually all the corporate debt.

The proposal to require the consent of the committee of creditors would involve the creditors in the process and also provide a means to inform them of any voluntary agreement, thereby avoiding secret arrangements between the administrator and the substantial chargee.

Parliamentary Committee report

The PJC did not support any extension of the 10 business day decision period.

Also, the PJC did not support the proposal that the administrator and substantial chargee could voluntarily agree to an extension of that period. It argued that this proposal would negate the provision requiring substantial chargees to make a decision whether to appoint a receiver during the 10 business day period. The PJC suggested that the Government may wish to clarify the operation of s 440B (PJC report, paras 6.45–6.52).

4.1.3 Partial exercise of substantial chargee's rights

[Discussion Paper paras 2.56–2.60]

The issue

Should a substantial chargee be permitted to exercise its rights over only some of the company's property?

Submissions

On one view, the legislation should give the substantial chargee this discretionary right, which could result in more corporate assets being available for the administration.

However, other submissions opposed introducing a partial exercise right, arguing that it could lead to divided control of the company's assets and also result in increased costs for the company.

Recommendation 25

Substantial chargees should not be given the power to exercise their rights over part only of their security.

Reasons

A partial exercise right could disadvantage some groups, such as employees, and lead to fragmented administration, contrary to the principle of unified management in a VA. This could undermine the administration's effectiveness.

4.1.4 Impact of appointment of receiver on administrator's indemnity rights

[Discussion Paper paras 2.121–2.126]

The issue

Is an administrator adequately protected where the substantial chargee appoints a receiver over the company's assets after the administration has commenced?

Currently, an administrator has:

- a right of indemnity over the company's property for:
 - any debts incurred by the administrator (and for which the administrator is personally liable), and
 - any approved remuneration (s 443D)
- a lien on the company's property to secure that indemnity right (s 443F), which applies to any debts incurred by, or remuneration accruing to, the administrator before receiving written notice of the appointment of a receiver (s 443E(3)).

Submissions

The general view in submissions was that it should be left to administrators to make commercial decisions whether to incur particular debts, taking into account the likelihood of a receiver subsequently being appointed and the impact of that appointment on the company's asset base.

However, one respondent proposed that, where the value of the administrator's right of indemnity is diminished or extinguished by the appointment of a receiver, the substantial chargee who appointed the receiver should cover the administrator for any shortfall.

Recommendation 26

The current indemnity rights of administrators should not be changed to take into account the appointment of a receiver.

Reasons

Administrators are currently protected by various lien rights against the company's property. If any circumstance arises where the lien rights may be inapplicable or inadequate (for instance, the anticipated professional costs will exceed the value of the company's property), it is up to the individual to decide whether to accept appointment as an administrator or continue in that office.

4.1.5 Timing of sale by receiver

[Discussion Paper para 2.55]

The issue

Should the law require receivers to postpone a sale of corporate assets if this would benefit unsecured creditors?

Currently, there are no time restrictions on the sale of corporate assets. Receivers are only required to take all reasonable care to sell the property at 'not less than [its] market value or otherwise the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold' (s 420A). However, the timing of the sale is a matter for the receiver, acting in the interests of the secured creditor, whether or not that timing is best for the unsecured creditors.

Submissions

Submissions generally opposed any timing obligation, raising concerns about who would have to make that judgment and the legal implications if the market for the assets fell during the period the sale was postponed. Also, that obligation could:

- introduce a speculative element over the future realisable value of the assets and the state of the market

- increase the costs and duration of the receivership, to the possible disadvantage of creditors generally.

Recommendation 27

There should be no obligation on receivers to postpone a sale of corporate assets.

Reasons

The legislation should not attempt to control the timing of an asset sale, for the reasons identified in the submissions.

4.2 Ipso facto clauses

[Discussion Paper paras 1.44, 1.53 and 2.191–2.206]

The issue

Should contractual ipso facto clauses (which have the effect of placing a company in default in specified circumstances, such as entry into a VA) be unenforceable against the company during the period it is in administration or be subject to some time restriction on enforceability during that period?

Typical ipso facto clauses under bank loans provide that the bank may terminate its obligation to lend any further funds, and can accelerate repayments of funds already lent, in the event of default.

Currently, there are no restrictions on the enforceability of ipso facto clauses.

This discussion excludes clauses that permit the appointment of a receiver. The rights of substantial chargees to appoint a receiver are dealt with in 4.1.1 of this report, while the right of any other chargee to appoint a receiver is excluded by s 440B.

Submissions

Retain the current position: all ipso facto clauses enforceable

Some submissions favoured this option, arguing that changing the current law would interfere with freedom of contract.

Prohibit enforcing ipso facto clauses during the course of the administration except where the administrator or the court consents

Several submissions supported the moratorium generally applying to the enforcement of ipso facto clauses, arguing that:

- it may give companies greater flexibility to enter into early negotiations with creditors
- no great damage is likely to result from interfering with contractual rights in this way
- administrators need to have the right to continue with contracts, rather than the decision being made by the counterparty, who would be protected by the ability to apply to the court and the administrator's personal liability
- enforcement of an ipso facto clause can effectively obliterate the business of the company and eliminate any opportunity an administrator may have to negotiate a sale of business and/or assets
- these clauses would still be enforceable with the agreement of the administrator or the court.

It was also argued that extending the moratorium to ipso facto clauses would provide an administrator with the opportunity to examine all options, including renegotiation of the contract or finding a purchaser of the business who can renegotiate the contract, without completely removing the other party's rights. This is in line with the current provisions in relation to owners and lessors of property occupied or used by the company.

Temporary freeze on enforcing ipso facto clauses

One submission favoured a freeze on enforcing ipso facto clauses for 21 days from the commencement of the VA, arguing that:

- these clauses may be a significant impediment to maintaining the trading operations and realising value from the assets of companies
- a temporary freeze has the potential to enhance significantly a large and complex enterprise's prospects of rehabilitation.

Administrators having power to override ipso facto clauses, with personal liability (and indemnity rights) if they do so

Some respondents favoured this option as an alternative to either a moratorium on the exercise of ipso facto clauses or a temporary freeze on the exercise of those clauses.

Recommendation 28

There should be no change to the current position under which ipso facto clauses can be enforced.

Reasons

The Committee acknowledges that there are arguments for prohibiting the enforcement of ipso facto clauses during any form of external administration:

- directors may be reluctant to put their companies into VA out of concern that this may result in creditors enforcing ipso facto clauses that in effect terminate the company's business. This delay may undermine a company's chance of financial recovery
- where the company under administration is capable of continuing to perform its obligations under a contract, the counterparty would suffer no disadvantage from a restriction on enforcing any ipso facto clause
- companies under administration can be deprived of the use of major assets, even where the counterparty has not suffered any immediate detriment
- all creditors should be in an equal position vis-à-vis a company that goes into administration
- a short moratorium on enforcing ipso facto clauses might assist administrators in the initial stages of an administration in working out the company's financial and commercial position, notwithstanding that it could in some instances disadvantage counterparties
- allowing the enforcement of ipso facto clauses may undermine a company's competitive position, for instance by enabling its customers to terminate their contracts with it and seek out other

suppliers, even where the company is continuing to provide the service for which the customer contracted.

However, there are strong countervailing arguments against extending the moratorium to ipso facto clauses, namely:

- the costs for financially healthy companies to obtain loan finance may increase if further restrictions are placed on the rights of secured creditors
- ipso facto clauses may be an important way for counterparties to protect their rights in the event of a VA. An example would be long-term suppliers of goods relying on an ipso facto clause following a company's entry into VA to decline to provide additional goods on credit
- directors can take into account any ipso facto clauses in their company's contracts with outsiders in determining whether to go into VA (though, in some instances, the company's financial position may in effect force directors into external administration)
- it can be very difficult to define clearly what constitute ipso facto clauses in particular contracts. For instance, is a contractual clause that states that the contract is rescinded if money is not paid or deposited by a particular date an ipso facto clause?
- the commercial consequences of interfering with rights under ipso facto clauses could outweigh the benefits to companies in VA, given the range of contracts that may be subject to ipso facto clauses, including real estate, intellectual property and personal services contracts
- restricting ipso facto clauses in a VA may be ineffective, as counterparties may simply draft clauses that are enforceable prior to a VA (for instance, on default short of insolvency or entry into a VA) or give themselves some other form of protection, such as a requirement that security amounts be paid at the counterparty's discretion. Currently, counterparties can choose not to enforce ipso facto clauses prior to a VA, despite a default, as they do not lose that right if a company goes into administration.

Ipsa facto clauses also have a differing effect depending on whether the company that goes into administration is buying from, or selling to, the contractual counterparty:

- *buying*: there is a strong argument that a counterparty should be able to rely on an ipsa facto clause to decline to provide the company in administration with any further goods or services, except on terms agreeable to that party, for instance cash payment by the company on or before provision of those goods or services
- *selling*: there may be a stronger case for requiring the company's contractual counterparty to maintain the contract, given that it is only obliged to pay if the company in administration provides the goods or services. However, a counterparty can better protect itself through an ipsa facto clause, which would give it the option to seek out an alternative supplier to avoid any possible failure by the company in administration. Companies in administration may be at greater risk of not being able to honour their contracts. Counterparties should be entitled to protect themselves against that risk of failure through ipsa facto clauses, rather than only being able to respond once a company has defaulted in providing goods or services.

Any move to restrict the enforceability of ipsa facto clauses in a VA could not be all-encompassing and may lead to legislative complexity. For instance, some ipsa facto clauses are enforceable under Chapter 11, for instance:

- a lender to a company that goes into Chapter 11 can rely on an ipsa facto clause to the extent of not having to provide further funds to the company, though it cannot accelerate repayments
- a person can rely on an ipsa facto clause to terminate a contract for the provision of personal services (in comparison, a creditor providing goods to the company cannot rely on an ipsa facto clause to refuse to supply further goods, but is entitled to immediate payment for any goods supplied while the company is under Chapter 11).

It also appears that US law allows anyone who has agreed to take up shares in a company that has subsequently gone into Chapter 11 to refuse to do so, relying on an ipsa facto clause.

The possible option of giving the court a discretion to override an ipso facto clause during the course of an administration may require the court to make commercial decisions about what clauses should be unenforceable, and for what reasons.

Furthermore, any move to restrict the enforceability of some ipso facto clauses could result in external parties devising other commercial arrangements to overcome these restrictions.

Preserving the enforceability of ipso facto clauses during VA does not mean that the contract must terminate. The contractual counterparty may in appropriate circumstances choose not to enforce an ipso facto clause or may be willing to renegotiate the contract, if sufficiently satisfied that its interests will be protected while the company is in VA.

If, contrary to the above recommendation, the moratorium were extended to some or all ipso facto clauses, the persons entitled to the benefit of those clauses may need to be given voting rights equivalent to those of creditors, given that those persons are not necessarily creditors.

Parliamentary Committee report

The PJC noted the competing arguments and submissions for and against permitting the enforcement of ipso facto clauses. It recommended that the law be amended so as to permit administrators to apply to a court for an order that a party to a contract may not terminate the contract merely because the corporate counterparty has gone into VA. The court should be satisfied that the contracting party's interests will be adequately protected (PJC report, paras 12.24–12.34, Recommendation 55).

4.3 Set-offs

[Discussion Paper paras 1.45, 1.53 and 2.168–2.172]

The issue

Should there be any change to the current position under which a creditor (usually a financial institution) can set off any debt owed to it by a company in VA against any funds that it holds on the company's account?

Submissions

Several submissions favoured retaining the right of set-off, arguing that:

- to do otherwise would endanger a large number of financial products
- set-off rights are already an established exception to the equality principle in a winding up
- accepted and well-understood contractual rights, such as the right to set-off, should not be adversely affected by any rehabilitation procedure.

Other submissions favoured extending the moratorium on creditors to the exercise by banks and other financial institutions of their right of set-off, arguing that:

- the exercise of a contractual right of set-off during an administration is contrary to the spirit and intent of Part 5.3A, being akin to the enforcement of a security against the company's property
- the chances of rehabilitation are slim if the company is denuded of cash under a set-off
- permitting financiers and bankers to exercise a contractual right of set-off after the appointment of an administrator effectively gives them a preferential payment over all other creditors
- the current ability to exercise a *contractual* right of set-off in a VA is wider than the statutory right of set-off on a liquidation under s 553C. A contractual right could extend to set-off in respect of post-appointment receipts. By contrast, a right of set-off under a liquidation only applies to transactions before the creditor receives notice of the company's insolvency.

One of those submissions said that this moratorium should extend until the conclusion of the major meeting of creditors.

Recommendation 29

There should be no change to the current position under which creditors can exercise set-off rights after the appointment of an administrator.

Reasons

Financial institutions such as banks in part manage their exposures on the basis of set-off rights. To interfere with these commercial arrangements could have various detrimental commercial effects, such as banks taking other actions to protect their interests, for instance periodically sweeping the accounts of solvent companies to set off debits and credits to ensure that there are no outstanding significant set-off exposures for any extended period.

4.4 Reservation of title (Romalpa) clauses

[Discussion Paper para 1.46]

The issue

Should there be any change to the current treatment of Romalpa clauses in a VA?

Romalpa clauses provide that title to goods does not pass from vendors (Romalpa creditors) to purchasers until they have been paid for. Currently, the right of a Romalpa creditor to repossess its goods is suspended during the moratorium period. That right subsequently revives, unless the creditor agrees otherwise under the deed or the court orders that the right continue to be suspended.

Submissions

No submission favoured any changes that would adversely affect the rights of Romalpa creditors.

Recommendation 30

There should be no change to the current position regarding the operation of Romalpa clauses during an administration.

Reasons

There is a strong case for continuing to prohibit the enforcement of these clauses during the moratorium period. Otherwise, Romalpa creditors may be able under the terms of their contract to strip the company of its trading stock and thereby undermine its commercial viability. Romalpa creditors can protect themselves by contractual requirements that the proceeds of any sale of affected stock must be held on trust for them, given that the relevant goods or other assets remain their property until paid for.

A further issue is whether Romalpa clauses should have to be registered, for instance by treating them as an additional category of registrable charge under s 262. Currently, Romalpa clauses are not registrable charges.

Arguments for registration are:

- providing stock pursuant to a Romalpa clause is the functional equivalent of lending money subject to a registered security. Romalpa creditors and financiers are both providers of working capital, the former advancing stock rather than cash
- registration would have the advantage of avoiding considerable administrative cost and effort by giving an administrator a convenient means of finding out which property in the company's possession was subject to a Romalpa clause
- Romalpa creditors gain an effective priority over other creditors, even though their interests are unregistered. This could be seen as unfair to those other creditors, as the Romalpa creditors have delivered the stock for resale by the debtor company and thus clothed the debtor company with the appearance of 'owning' the stock.

However, registration may have limited benefits, in view of the administrative burden involved and given that it is well understood that companies in certain industries, for instance retailing and manufacturing, almost invariably hold stock subject to these clauses.

Also, the question of registration of Romalpa clauses raises broader corporate law issues, not confined to administrations or liquidations.

5 Other matters affecting creditors

Should there be any change to the current VA approach to lenders to companies under administration, creditors exchanging their debt for equity, the operation of a committee of creditors and deeds that depart from the statutory winding up priorities?

5.1 Lending to a company under administration

[Discussion Paper paras 1.56–1.61 and 2.82–2.100]

The issues

Should lenders to a company under administration have any priority over pre-administration secured or unsecured creditors?

Should those lenders have a right of recovery against the administrator (with the administrator having indemnity rights against the assets of the company)? Currently, the recovery and indemnity rights apply to goods, services and property, but not loan funds, provided to the company.

Submissions

Priority

One submission strongly favoured giving priority to lenders during an administration, in a manner similar to that under Chapter 11, arguing that:

- in the absence of priority financing, the ability of a company to restructure is extremely limited
- a recent Canadian Senate Banking, Trade and Commerce Committee report (November 2003) recommended the following legislative amendments:

- give the court jurisdiction to provide that a new lender's security has priority over such pre-administration security interests as the court specifies
- require notice of the court hearing to any secured creditor affected by the proposed super-priority
- require the court to consider the proper governance of the corporation during the administration (taking into account that the board of directors remains in office under the Canadian system) and whether the possibility of the loan enhancing the prospects for rehabilitating the company would overcome any material prejudice to existing creditors as a result of the company's continued operations.

Various submissions opposed giving any priority to a new financier, as:

- a company would, in the absence of this priority, be more likely to rely on an existing financier, who may be more likely than a new financier to consider the long-term interests of the company, given its existing exposure
- any displacement of pre-existing security may allow a new financier to fund a fruitless turnaround attempt and thereby erode the security of pre-administration secured creditors without their consent.

Personal liability of administrator with indemnity rights

Some submissions favoured extending the administrator's personal liability and indemnification rights beyond goods and services to money lent to an administrator for the purpose of the administration, arguing that this extension may:

- encourage the provision of debt financing to companies in financial difficulty
- result in an appropriate priority for repayment above ordinary unsecured creditors
- contribute to prudent and sound decision making by administrators, given their personal liability.

However, some submissions stipulated certain provisos:

- the parties to the loan should be able to contract out of the administrator's personal liability and indemnity rights, or
- the administrator's personal liability ought to apply only up to the value of the company's assets.

A contrary view was that often it would not be commercially realistic to expect administrators to incur personal liability for borrowings of the magnitude required to finance some reorganisations.

Recommendation 31

A post-administration lender should not be granted any priority over any pre-administration secured creditor, except with the consent of that creditor.

A post-administration lender may be given a priority over all pre-administration unsecured creditors if that priority is approved by three quarters by value and a simple majority by number of those pre-administration unsecured creditors who vote on the resolution.

There should be no change to the current law whereby administrators are not personally liable for loan finance obtained during the course of an administration.

Reasons

Secured creditors

A first-ranking secured financier may choose to advance further working capital during the course of the administration, or agree to give a new financier priority as an incentive to provide funds. Any introduction of a super-priority mechanism along the lines of Chapter 11, whereby the court may grant priority without the consent of the secured creditor, may force the court to make commercial decisions and prudential judgments about whether the merits of that commercial arrangement justify eroding the rights of existing secured creditors over particular assets. Also, the displacement of pre-administration security may facilitate risky or unsuccessful turnaround attempts.

Unsecured creditors

A principle underlying Part 5.3A is that unsecured creditors are generally bound by any decision of creditors reached by the requisite majority in value and number. This principle can be applied in the context of post-administration financing by permitting the requisite majority of unsecured creditors to give a priority to the new financier's interests over their own interests. This may also promote the long-term interests of creditors by assisting an administrator to obtain the necessary finance to restore the company to economic viability.

Personal liability

The argument for administrators being personally liable, with indemnity rights, for loan finance obtained during the course of an administration is that it would bring loan finance into line with the supply of goods and services (where the administrator has personal liability, with indemnity rights). However, this change would in effect give new lenders priority over holders of floating charges, given that an administrator's indemnity rights have priority over those charges (s 443E). Also, administrators may be reluctant to seek substantial loan finance if they were subject to personal liability, even with indemnity rights.

5.2 The committee of creditors

5.2.1 The role of the committee of creditors

[Discussion Paper paras 1.32–1.34]

The issue

Should the current limited role of the committee of creditors be enhanced?

The current functions of the committee are:

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

Submissions

One suggestion was to give the committee of creditors the power to pass resolutions, at least in large enterprise VAs, where the major meeting of creditors may be postponed or adjourned for a considerable period of time. However, most submissions saw no need to change the role of this committee, in the absence of introducing a Chapter 11 procedure.

Recommendation 32

The committee of creditors should have the following additional powers:

- to approve administrators' fees on an interim basis (Recommendation 18), or
- to approve a substantial chargee continuing to have the right to appoint a receiver after the decision period (Recommendation 24).

Reasons

There is no need for the committee of creditors to exercise a continuing monitoring function similar to that under Chapter 11 where the board of directors remains in control of the company. All key decisions should remain with creditors collectively at the major meeting, other than those referred to in Recommendations 18 and 24.

5.2.2 Membership of the committee of creditors

[Discussion Paper para 2.236]

The issue

Should there be any restrictions on the size of the committee of creditors, or who can serve on it?

Submissions

One view favoured limiting the size of the committee of creditors to a maximum of around twelve members, arguing that large committees can become unwieldy and ineffective. However, administrators should have the discretion to increase this number in

appropriate cases to allow for proper representation of the creditor groups, for instance where:

- a particularly large corporate entity or group structure is involved, and/or
- there are a large number of distinct creditor groups.

Other submissions opposed any statutory limit on the number of creditors on a committee of creditors, arguing that it may appear inequitable or prove unduly inflexible in particular administrations. For instance, there was no justification for restricting committee members to, say, the five largest creditors and two employee representatives (as in US Chapter 11), as small creditors may have the same interest as large creditors in the rehabilitation of the company.

Recommendation 33

There should be no regulation of the size or membership of a committee of creditors.

Reasons

It should remain a matter for creditors themselves to determine which creditors, and how many, should comprise the committee of creditors.

5.2.3 Corporate membership of the committee of creditors

[Discussion Paper para 2.236]

The issue

Should a corporation be permitted to be a member of the committee of creditors?

This may not be possible under the current law, given that s 436G (membership of committee) refers to 'he or she'.

Submissions

Submissions generally agreed that a company should be permitted to be appointed as a member of the committee of creditors. Problems can arise if an administration continues for any length of time and a corporate creditor wishes or needs to change its representative on the committee, for instance if that person leaves the company.

Recommendation 34

The legislation should make clear that a corporation can be a member of a committee of creditors.

Reasons

There is no reason to limit membership of a committee of creditors to natural persons, given that an entity can act through whatever representative it designates from time to time.

It is unclear whether s 436G permits a corporation to be a member of a committee of creditors. On one view, this is implied by virtue of the *Acts Interpretation Act 1901* s 23, which states that ‘In any Act, unless the contrary intention appears ... words importing a gender include every other gender’. The opposing argument is that the language of s 436G, and the specific means in s 436G(b) and (c) which corporate creditors could use to appoint individuals to represent their interests on the committee, display an intention to limit membership to natural persons. The legislation should put this matter beyond doubt.

5.3 Equity for debt swaps

5.3.1 Types of swaps

Voluntary swaps

A deed of company arrangement may authorise the deed administrator to make offers to creditors of a company under administration to take up its equity in exchange for their debt. Each creditor has the choice whether to accept these lower ranked shareholder rights. Creditors may be inclined to do so, for instance, if they anticipate the company returning to profitability after the

administration. These equity for debt swap offers raise issues concerning the prospectus provisions (5.3.2), financial product disclosure (5.3.3) and, in some circumstances, the takeover provisions (5.3.5).

Mandatory swaps

A deed may require that creditors take equity in lieu of their debt. This raises questions about the enforceability of such mandatory provisions (5.3.4), as well as, in some circumstances, the application of the takeover provisions (5.3.5).

5.3.2 Prospectus disclosure

[Discussion Paper paras 2.136–2.140]

The issue

Should an offer by an administrator to creditors to substitute equity for all or part of their debt (equity for debt offer) be exempt from the fundraising provisions?

Submissions

Some submissions supported exempting equity for debt offers under a deed of company arrangement from the prospectus disclosure requirements, arguing that:

- the information in the report provided by the administrator to creditors and the general safeguards in Part 5.3A are sufficient
- Part 5.3A already has safeguards against unfairly discriminatory deeds, such as the requirements for administrators to act in the best interests of creditors, the liability of administrators for misleading and deceptive conduct or statements and the court's power to terminate a deed.

However, another view was that a prospectus should be provided to all creditors who are requested to provide additional cash under the swap arrangements, except for any creditors who are professional investors.

Recommendation 35

An administrator making an equity for debt offer should only be required to provide a statement setting out all relevant information that the administrator knows or ought reasonably to know (regardless of the size of the fair value of the debt involved) where that offer does not require accepting creditors to contribute any further consideration under that offer. The administrator's statement should indicate that it is not a prospectus and therefore may contain less information than a prospectus.

Reasons

On one view, the level of disclosure to creditors receiving an equity for debt offer should be no less for companies in financial difficulty than for solvent companies. However, there are pragmatic arguments for granting an exemption from the full prospectus requirements where the creditors are not required to provide any further consideration under the offer. In those instances, the administrator should be required to provide all relevant information that the administrator knows or ought reasonably to know. Beyond that, the administrator should not be obliged to undertake a full due diligence exercise, as required for a full prospectus. However, as with an offer information statement, creditors should be put on notice that they may be receiving less information than under a full prospectus (cf s 715(1)(g)).

This recommendation refines Recommendation 58 of the 1998 VA report that 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.

5.3.3 Financial product disclosure

[Discussion Paper paras 2.141–2.143]

The issue

Should equity for debt offers be exempt from the financial product disclosure requirements?

Submissions

Some submissions supported an exemption from this disclosure, for the same reasons as for prospectuses. Other submissions saw no reason why administrators should have an exemption from complying with this disclosure requirement.

Recommendation 36

Equity for debt offers should not be exempt from the financial product disclosure requirements.

Reasons

There is no compelling case for exempting administrators from these disclosure requirements. They do not involve the administrator in the type of due diligence research and analysis needed for a prospectus.

5.3.4 Mandatory swaps

The issue

Should a deed that obliges creditors to take equity in lieu of their debt bind any dissenting creditors?

Current law

The Corporations Act does not clearly resolve this matter. On the one hand, a deed of company arrangement binds all creditors (s 444D(1)). However, s 231 contemplates a person becoming a shareholder through voluntary agreement.

There is some authority that s 444D must be read subject to other provisions of the Corporations Act: *Derwinto Pty Ltd (in liq) v Lewis* (2002) 42 ACSR 645 at 654, para [44]. On this basis, s 231 may protect a creditor from being forced to become a shareholder.

However, there is also authority that a Part 5.1 scheme of arrangement can bind a creditor to become a member of a company, given the particular procedures in this Part to protect the interests of dissenters: *Re Hunter Resources Ltd* (1992) 107 ALR 398 at 406. On one view, there are analogous protective procedures in Part 5.3A, in particular the right of a creditor to seek a court order terminating a deed (s 445D).

Recommendation 37

The legislation should make clear that all affected creditors are bound by an equity for debt swap in a deed of company arrangement.

Reasons

Creditors opposing a mandatory swap can attempt to influence other creditors to vote against any draft deed containing such a clause or could apply to the court to terminate a deed after its approval (s 445D). Subject to exercise of those rights, all creditors should be bound by the deed. Letting each creditor decide whether to be bound by an equity for debt swap under an approved deed could result, in some circumstances, in the unravelling of the whole rehabilitation strategy.

5.3.5 Takeover provisions

[Discussion Paper paras 2.144–2.160]

The issue

Should equity for debt swaps be exempt from the takeover requirements?

Under the current law, equity for debt swaps that would otherwise breach the takeover provisions can proceed if approved by shareholders, ASIC or the Takeovers Panel.

Submissions

On one view, such swaps should be exempt from the takeover provisions, given the safeguards under Part 5.3A against unfairly discriminatory deeds that include equity for debt swaps, such as the requirements for administrators to act in the best interests of creditors, administrators' liability for misleading and deceptive conduct or statements and the court's power to terminate a deed.

Other submissions supported:

- giving the court an express power to exempt a deed of company arrangement from the takeover provisions, without removing the ability of administrators to seek approval from shareholders,

ASIC or the Takeovers Panel. All interested parties including creditors and shareholders should have the right to be heard on any court application

- providing the court with legislative guidelines on when an order is appropriate, for instance, where the shares in the company are effectively worthless.

However, some concern was expressed about the burden of possible court costs on either the applicant administrator (and therefore the company) or on any objecting party.

Recommendation 38

There should be no change to the current procedures for exempting equity for debt swaps from the takeover provisions.

Reasons

ASIC and, where it is not willing to grant an exemption, the Takeovers Panel can deal with the merits of each application, taking into account any need to protect the interests of shareholders.

5.4 Deeds that depart from the statutory winding up priorities

[Discussion Paper paras 1.54 and 2.212–2.214]

The issues

Should there be statutory clarification of whether deeds of company arrangement can adopt an order of payments that differs from that applying under ss 556 ff on a winding up?

There is judicial authority for the proposition that creditors may approve deeds that depart from those priorities, provided ‘at least that the administrator takes steps to ensure, so far as it is possible, that the deed is no less beneficial to all creditors than liquidation is likely to be’ (*Lam Soon Australia Pty Ltd (Administrator Appointed) v Molit (No 55) Pty Ltd* (1996) 14 ACLC 1,737 at 1,750).

Submissions

Various submissions favoured legislative provision to put beyond any doubt that creditors can approve deeds of company arrangement that depart from winding up priorities, with any aggrieved creditors having an express right to seek court review if they consider that a deed is unfairly prejudicial to them.

One of those respondents proposed that administrators' reports be required to provide full disclosure of the implications for priority creditors of any divergence from the statutory winding up priorities. That respondent noted the importance of such disclosure for employees, given that the Department of Employment and Workplace Relations Operational Arrangements state that employees are not eligible to claim under the General Employees Entitlements and Redundancy Scheme (GEERS) where a deed departs from the statutory winding up priorities.

A contrary view was that there should be an express prohibition on permitting deeds to depart from the statutory priorities, as the majority in both number and value will usually be non-priority unsecured creditors, who may therefore have sufficient voting power to remove the statutory priority protections afforded to certain classes of creditors, particularly employees.

Another respondent proposed amendments to the s 556 statutory priority for employee entitlements in a winding up.

Recommendation 39

It should be made clear that a deed of company arrangement is not invalid merely because it departs from the statutory winding up priorities. This recommendation does not take a particular position on the treatment of employee entitlements, to which special considerations may apply.

Reasons

There could be good commercial reasons for departing from the priority payment requirements in particular situations, for instance, to elevate the rights of key suppliers on which the company will depend in the future. Dissatisfied creditors can apply to the court to have a deed terminated on the ground that its departure from the statutory winding up priorities unfairly discriminates against them.

Recommendation 39 deals with priorities in general terms only. It does not make any recommendation one way or the other on employee entitlements. The Discussion Paper stated that the Advisory Committee did not intend to review these entitlements, given that the PJC was examining this matter in detail under one of its specific terms of reference and the complex questions raised by employee entitlements were not confined to large and complex enterprises (DP paras 2.218 and 2.221).

Parliamentary Committee report

The PJC recommended that the law be amended to make it mandatory for a deed of company arrangement to preserve the priority available to creditors in a winding up under s 556(1), unless affected creditors agree to waive their priority. The amendment should, however, allow creditors or the administrator the right to initiate court proceedings to have the deed upheld if in the court's view the deed offered the dissenting creditors a better return than they would obtain in a liquidation (PJC report, Recommendation 49).

6 Pooling

Should companies in a corporate group be permitted to enter into a pooled administration and, if so, in accordance with what procedures?

6.1 The benefit of pooling in VA

The Advisory Committee, in its *Corporate Groups Report* (May 2000), examined the role of corporate groups in Australian commerce and the economic and business benefits that the group structure offers.

That report pointed out that the affairs of companies in a corporate group may be closely intertwined, with the financial standing of one group company being significantly affected by the level of solvency of other group companies, for instance, through intra-group cross-guarantees.

That report recommended that, where appropriate, voluntary administrations and liquidations of insolvent group companies be permitted to be combined (pooled) to simplify and expedite the recovery or winding up process.

This report develops and refines the concept of pooling in the context of VA.

6.2 The concept of pooling

In the context of this report, pooling refers to the unified administration of various companies in VA, including combining their assets and liabilities as if in one company, treating the creditors of all the companies as if they were creditors of that company, and giving creditors the right to enter into a single deed of company arrangement that binds all affected parties.

Creditors of all pooled companies would be treated as one class, voting in one meeting according to number and value on a single deed of company arrangement. However, the following features of the current law would remain:

- pooling would not affect the rights of external secured creditors (cf Recommendation 23 of the *Corporate Groups Report*)
- any aggrieved creditor could object to the deed of company arrangement
- deeds of company arrangement could permit a differentiated rate of return to creditors of different companies in the group, where this is appropriate and equitable.

Pooling is a facilitative process for use where considered appropriate. It can assist the rehabilitation process where a number of companies in financial difficulties have a sufficient community of interest, or their business affairs are sufficiently intermingled, that they consider it more effective to have a combined administration, rather than separate administrations.

6.3 Current law

The courts have permitted voluntary pooling under VA in some circumstances.

In *Dean-Willcocks v Soluble Solution Hydroponics Pty Ltd* (1997) 24 ACSR 79, the court relied on s 447A to permit pooling where creditors approved combining recoveries, costs and distributions to creditors in the relevant companies under administration. In this case, all the creditors (except one absent creditor) had agreed that the assets and liabilities of each company should be consolidated. The court approved this pooling, subject to the absent creditor having an opportunity to agree with, or to move the court to discharge, the pooling order.

Likewise, in *Mentha v GE Capital Ltd* (1997) 27 ACSR 696, the administrators of various companies in a corporate group devised a pooling arrangement under which:

- the administrators would transfer all the assets of the various group companies under administration into one company (the

pooled company), which would also assume the obligations of all the group companies

- secured creditors of the various group companies would be given new securities over the assets of the pooled company
- the unsecured creditors of those various group companies would have residual rights of recovery against the assets of the pooled company.

The Federal Court approved this pooling following separate meetings of the creditors of each group company, who overwhelmingly supported the proposal (97% by value of creditors present and voting). The court noted that this arrangement prima facie contravened the insolvency rule that the unsecured creditors of a company are usually only entitled to a rateable share of the assets of their own insolvent debtor. However:

the power to enter into a deed of company arrangement under Part 5.3A is sufficiently broad to permit an arrangement binding on two or more insolvent companies pursuant to which their respective assets and creditors will be consolidated (at 702).

The court has also used its discretionary VA power under s 447A to approve the pooling in a liquidation of the assets and liabilities of companies that had been in VA, despite the objection of a creditor: *Re Dean-Willcocks* (2004) 50 ACSR 15.

6.4 Proposals for reform

[Discussion Paper paras 1.71–1.72, 2.31–2.32 and 2.176–2.190]

The Advisory Committee, in its *Corporate Groups Report* (paras 5.71–5.80 and Recommendation 20), recommended amendments to the corporations legislation to facilitate pooling in VAs. It recommended that these amendments permit administrators, at their discretion, ‘to pool the administration of several companies, either where no creditor who attends the creditors’ meetings votes against the proposal or the court otherwise approves’. A pooling would permit ‘deeds of company arrangement that bind more than one company’.

In this report, the Advisory Committee develops and refines this recommendation for voluntary pooling by:

- clarifying the types of relationships between companies (hereinafter referred to as group companies) that would make them eligible for pooling
- expressly permitting solvent group companies to be included in a pooled group administration
- replacing the requirement in the earlier proposal for creditors' meetings to approve pooling with a right for administrators to proceed with a pooled VA unless creditors object. This would streamline the approval process by avoiding the need to call a meeting of creditors of each affected company for that purpose, while still ensuring that creditors are fully informed and have adequate means to challenge any pooling proposal.

6.4.1 Definition of corporate group in the context of pooling

The issue

What should be the prerequisite relationship between companies for them to constitute a group for the purpose of permitting pooling?

Submissions

No submissions commented on this matter.

Recommendation 40

Pooling should be permitted where there is:

- a common ownership structure
- a common exposure to specific actual or contingent liabilities, or
- ownership or operation of corporate assets in a common scheme or undertaking.

Reasons

The recommendation would permit pooling for holding/subsidiary companies or other related companies, as these companies have a common ownership structure. However, pooling should not be limited to these companies. The other criteria in the recommendation would, for instance, permit pooling of unrelated companies in a joint venture.

6.4.2 Solvent group company entering into a pooled VA

The issue

Should solvent group companies (that is, group companies that do not satisfy the prerequisite test for entering into VA of being ‘insolvent or likely to become insolvent’) be permitted to enter into a pooled VA where at least one group company satisfies the VA prerequisite?

Submissions

Several submissions supported solvent group companies having the discretion to enter into a pooled VA where the survival of the vital components of the corporate group as a whole would be best facilitated by this process.

Recommendation 41

Solvent group companies should be permitted to enter into an administration with other group companies where at least one of those companies satisfies the voluntary administration prerequisite.

Reasons

There may be instances where the affairs of a solvent group company are so intertwined with those of other group companies that are, or are likely to be, insolvent that it may be beneficial to pool all of them in VA. Examples would be where the solvent group company:

- depends on commercial arrangements between one of the insolvent group companies and outsiders

- relies on information technology or other logistical support, or relies on financial support, from an insolvent group company.

The pooling procedure should be the same as for insolvent companies participating in a group pool (6.4.3, below), except that the directors of the solvent company, rather than the administrator, should have the discretion to resolve that the company join the pool.

6.4.3 The pooling process

The issue

What should be the procedure for the voluntary pooling of group companies?

Submissions

Several submissions considered that any pooling of group companies should be a matter for decision by the creditors of all those companies. A VA should not alter creditors' rights against a particular entity unless those creditors agreed or the court so ordered.

Recommendation 42

Where no existing pool

The initial decision whether to pool should rest with the directors of any solvent group company, and the administrator of any other group company, in the proposed pool.

Where the directors or the administrator of a group company have decided to pool, they must:

- give written notice of that intention to all creditors of that company, together with:
 - a statement identifying the other group companies in the proposed pool
 - a summary of all material information known to the directors or the administrator (as the case may be) that is relevant to the creditors' decision whether to object to the pooling of those group companies

- a statement of the right of any creditor to object, and the procedure for lodging that objection with the company.

The pooling may proceed provided:

- in relation to each group company in the proposed pool, no creditor of that company objects within a prescribed period, or the court confirms the pooling on the application of the company, notwithstanding that objection, and
- this procedure is satisfied for all the group companies in the proposed pool.

Unless all the group companies can participate in the proposed pool, the pooling cannot take place. The approval process would need to be repeated for any new pooling proposal.

Adding to an existing pool

A group company may join an existing group pool only if:

- that company complies with the above approval process
- the administrator of the existing pool agrees, and
- the creditors of the companies in that pool do not object (after being informed as above), or the court overrides their objections.

Reasons

The proposed pooling process could take some time, given the requirement for written notice, the prescribed period for creditors to lodge objections and the need for a court determination in the event of any such objection. However, each of these steps is necessary, as pooling has the potential to affect considerably the interests of creditors of particular companies. Also, pooling should be permitted only if all the proposed companies can proceed, given that creditors were asked to consider the merits of all the identified group companies being included in the pool.

The court's powers should be limited to whether to approve a company entering the pool. The court should not have an additional power to vary any pooling proposal. This could result in the available assets in the proposed pool differing from what was originally described to creditors of all the group companies in the

proposed pool. Arguably, all those creditors should have a further right to object to the proposed pooling, which in turn could indefinitely delay or complicate the process of settling the pool.

In practice, administrators may be able to expedite the pooling approval process and reduce costs by sending out the notice of the proposed pooling and relevant information with the notice of first meeting.

7 Governance and other matters

Should the corporate governance rules be relaxed for companies under administration?

7.1 Financial reporting requirements

[Discussion Paper paras 2.225–2.226]

The issue

Should companies in VA be exempt from the financial reporting requirements in the Corporations Act?

Submissions

There was some support for suspending a company's financial reporting requirements while it is under administration.

However, other respondents argued that companies under administration should still be required to provide adequate financial reports to shareholders, who:

- have fewer rights than creditors to receive information on the progress of the administration, even though they may still have significant economic interests in the company
- may have potential tax losses, for which financial information is required.

It was also argued that ASIC is reasonable in granting exemptions and deferrals under Policy Statement 174.

Recommendation 43

Companies under administration should not be exempt by statute from the financial reporting requirements.

Reasons

No change to the current law is necessary, as ASIC can grant exemptions or deferrals in appropriate cases.

Parliamentary Committee report

The PJC recommended that disclosing entities in administration not be excused from preparing and lodging financial reports. It noted that ASIC may grant relief in appropriate cases (PJC report, para 6.91).

7.2 Annual general meeting

[Discussion Paper paras 2.227–2.230]

The issue

Should companies in VA be exempt from the annual general meeting requirements in the Corporations Act?

Submissions

Some respondents supported the administrator having a discretion not to hold an AGM where, in the administrator's opinion, there is no remaining value in the shares, provided that shareholders are otherwise adequately informed about the progress of the administration.

A contrary view was that no change to the current law is necessary, as ASIC is reasonable in granting exemptions and deferrals under Policy Statement 174.

Recommendation 44

Companies under administration should not be exempt by statute from the annual general meeting requirements.

Reasons

No change to the current law is necessary, as ASIC can grant exemptions or deferrals in appropriate cases.

Parliamentary Committee report

The PJC recommended that disclosing entities in administration not be excused from holding annual general meetings. It noted that ASIC may grant relief in appropriate cases (PJC report, para 6.91).

7.3 Minimum number of directors

[Discussion Paper paras 2.231–2.232]

The issue

Should companies in VA be exempt from the statutory requirement to maintain a minimum number of directors?

Currently, a public company must have at least three directors and a proprietary company at least one director (s 201A).

Submissions

Several submissions supported having no requirement for a minimum number of directors while a company is under administration (including under a deed administrator), as the directors have no role to fulfil at that time. However, a company under administration should have the required number of directors if and when it returns to the control of the directors.

A contrary view, in support of retaining this requirement, was that VA is simply an interim step and does not permanently replace the company's directors, who may resume control if the company enters into a deed of company arrangement.

Recommendation 45

Companies under administration should not be exempt by statute from the requirement to have a minimum number of directors.

Reasons

ASIC does not have the power to reduce the statutory minimum number of directors. It may be difficult to maintain this statutory minimum, especially in the case of public companies, if directors retire or resign and other individuals are unwilling to take on the

role. However, ASIC would be unlikely to take action against a company that is under administration merely because that company cannot recruit anyone to make up the minimum number of directors.

7.4 Directors and officers insurance

The issue

Should there be any changes to the discretionary power of an administrator in relation to renewing any directors and officers insurance that falls for renewal during the course of the administration?

Submissions

Some respondents argued that, to ensure that appropriately qualified persons are willing to serve as directors or other officers, there should be some assurance that they will continue to be covered by any D&O insurance previously taken out by the company on their behalf if that company is in VA when the time for renewal of the policies arises.

Recommendation 46

It should remain a matter for the administrator's discretion whether to renew any D&O insurance.

Reasons

It is possible that some directors may have reservations about placing their companies in VA if their D&O cover would probably fall for renewal during the period of the administration. However, there are countervailing factors, namely that they have a duty to act in the best interests of the company and may place themselves at risk of insolvent trading if they delay the company entering into VA. It should remain a matter for administrators to determine whether it is in the overall interests of the company to renew any D&O insurance.

7.5 Deed of company arrangement overriding a company's constitution

[Discussion Paper para 2.235]

The issue

Should a deed of company arrangement be able to override a company's constitution?

Submissions

Various submissions considered that a deed of company arrangement should, to the extent of any inconsistency, override the company's constitution. Those submissions argued that:

- the creditors now control the company
- constitutional provisions such as those relating to the retirement of directors are redundant while the deed remains in force.

A contrary view was that any overriding of the company's constitution through the deed could substantively change the shareholders' contract with the company, without their consent.

Recommendation 47

There should be no statutory provision permitting a deed of company arrangement to override a company's constitution.

Reasons

There is no compelling case for permitting a deed of company arrangement to override a company's constitution. This could fundamentally alter a company's internal corporate structure, including the powers and rights of shareholders, without those persons having any role in that process.

7.6 Transfer of shares in companies under administration

[Discussion Paper para 2.238]

The issue

Should on-exchange or off-exchange trading of shares in companies under administration be permitted?

Currently, share transfers in any companies under administration are void unless the court orders otherwise (s 437F). Therefore, trading in the securities of entities that go into VA is suspended.

Submissions

All submissions on this matter confined their comments to on-exchange share trading.

Various respondents opposed on-exchange trading in shares of a company under administration, arguing that:

- the administrator may be unable to comply with the relevant disclosure obligations, and
- potentially sensitive information that would be made available to creditors under a VA may not be widely available to the market.

One respondent noted that, while on-exchange trading of shares under Chapter 11 is not prohibited, the United States Securities and Exchange Commission:

- points out that companies that file under Chapter 11 are generally unable to meet the listing standards to continue to trade on the widely recognised exchanges, and
- advises investors that buying common stock of companies in Chapter 11 is extremely risky and is likely to lead to financial loss, given that the creditors and the bondholders generally become the new owners of the shares of a company that emerges from Chapter 11 as a viable entity, with the existing equity shares cancelled or substantially diluted.

Another respondent queried who would pay the administrative costs of recording the on-exchange share transfers. It suggested that the creditors should not be required to meet these costs from their entitlements to the company's assets, as they may receive no benefit from these market transactions.

Recommendation 48

There should be no change to the current law regulating transfers of shares in companies under administration.

Reasons

The likely policy behind the restriction on on-exchange and off-exchange share transfers is to protect the creditors of a company under administration (*Selim v McGrath* [2003] NSWSC 806). For instance, creditors could be disadvantaged if holders of partly paid shares could transfer them to an entity with no assets. There is no apparent case for providing any exemption for on-exchange trading.

7.7 Change of company name

[Discussion Paper paras 2.233–2.234]

The issue

Should administrators or deed administrators have unilateral power to change the name of a company?

Currently, only shareholders, by special resolution under s 157, have this power.

Submissions

Some submissions supported administrators/deed administrators having the power to change the company's name if, in the administrator's opinion, it is desirable to do so in the interests of the company. However, the former name should be disclosed for six months, so that creditors are fully informed. This is particularly important for advertisements for meetings and any payments to creditors.

Other respondents did not support permitting administrators to change company names without shareholder approval, arguing that it could facilitate phoenix companies.

Recommendation 49

There should be no change to the statutory requirement that only shareholders, by special resolution, can change the name of a company in administration.

Reasons

No convincing case has been made for permitting an administrator or a deed administrator unilaterally to change the name of a company in VA.

7.8 Use of relation-back day concept

[Discussion Paper para 2.130]

The issue

Should there be any adjustment to the relation-back day concept to take into account that a liquidation may follow an administration?

Currently, the 'relation-back day' concept performs two distinct functions:

- *retrospective effect*: various corporate transactions that have taken place within certain periods **before** the relation-back day can be set aside as voidable transactions (s 588FE) (the periods are 6 months for insolvent transactions, 2 years for uncommercial transactions, 4 years for related party transactions and 10 years for fraudulent transactions)
- *prospective effect*: the liquidator has three years **after** the relation-back day, or such further time as the court permits, to apply to the court to undo those transactions (s 588FF(3)).

Submission

One respondent suggested that, where a liquidation follows the failure and termination of a deed of company arrangement, the three year time limit for making an application for a court order relating to a voidable transaction should only commence once the deed has terminated, so that the liquidator does not face a shortened period within which recovery actions must be commenced or even find that the time has expired before termination of the deed and commencement of the liquidation.

Recommendation 50

Paragraph 588FF(3)(a) should be amended by adding after 'within three years after the relation-back day' the following: 'or within 12 months after the date of appointment of the liquidator, whichever is the later'.

Reasons

The relation-back day concept is appropriate in relation to its retrospective effect. However, that concept alone is not appropriate for determining the time within which a liquidator must commence court proceedings in relation to voidable transactions (its prospective effect).

Under its retrospective effect, the relation-back day in some instances is intentionally a date earlier than the commencement of the liquidation. For instance, where a VA has preceded a liquidation, the relation-back day is the date of the appointment of the administrator (and an even earlier date in some circumstances under Recommendation 52 of the 1998 VA report⁴).

The prospective effect of the relation-back day may considerably reduce (or in the case of a very long-running administration eliminate) the period available to a liquidator to commence litigation to undo voidable transactions. On one view, liquidators should be given adequate time to commence litigation to unwind those transactions. However, the interests of the counterparty to potentially voidable transactions should also be recognised. The proposal to

⁴ Where a VA precedes a liquidation, but the winding up application was made before the VA commenced, the 1998 VA report recommended that the relation-back day should be the day on which the winding up application was filed.

give liquidators three years from the relation-back day, or 12 months from the date of their appointment, whichever is the later, to commence this litigation is a pragmatic way of dealing with these competing interests.

8 Creditors' schemes of arrangement

Are any changes needed to the creditors' scheme of arrangement provisions to make them a more effective method of corporate recovery?

8.1 Use of schemes

As explained in greater detail in Part 3 of the Discussion Paper, creditors' schemes of arrangement (creditors' schemes) tend to be utilised in two circumstances:

- where a company is in financial stress but is not at immediate risk of insolvency
- where a company is already in external administration (for instance, provisional liquidation) and a scheme is proposed in lieu of liquidation or a VA.

8.1.1 Companies in financial stress

Creditors' schemes may be a very useful means to restructure the financial affairs of companies that are experiencing financial difficulties, but are not insolvent or likely to become insolvent. Schemes have the attraction for incumbent boards that directors remain in control throughout the restructuring process. In some cases, maintaining this continuity may be considered necessary to overcome possible disruptions to the company's activities that could occur through the appointment of an external controller (as under VA or provisional liquidation) and which could impede, or reduce the likelihood of, a successful financial recovery.

Directors contemplating creditors' schemes need to consider carefully their lack of protection from the insolvent trading provisions during the considerable time usually required to prepare a scheme and have it approved by the creditors and the courts. Directors can reduce this risk by entering into voluntary transitional

financial arrangements with the company's external creditors, such as those creditors agreeing to provide continuing funding support to the company, or forbearing from enforcing some or all of their rights, during the scheme preparation period.

8.1.2 Companies in provisional liquidation

Directors of an insolvent, or near insolvent, company may choose to appoint a provisional liquidator as an interim step towards the possible eventual rehabilitation of the company, rather than merely have it wound up. Control of the restructuring process would, as in a VA, be in the hands of an external party. It remains a matter for the directors to determine whether, in their particular circumstances, appointing a provisional liquidator with a view to eventually proposing a creditors' scheme would be preferable to a VA, taking into account the differences between these two procedures (as summarised in Part 3 of the Discussion Paper).

8.2 Submissions

The Committee in its Discussion Paper invited submissions on any suggestions that may assist in making the Part 5.1 scheme of arrangement provisions more useful for rehabilitating large and complex enterprises.

Those respondents that commented on creditors' schemes of arrangement supported retaining them as an alternative method of corporate financial restructuring. No respondent proposed any changes to the current statutory scheme.

8.3 Advisory Committee position

The Committee makes no recommendation in relation to the creditors' scheme of arrangement provisions, given that no submissions suggested any changes to these provisions to assist the rehabilitation of large and complex (or other) enterprises.

Appendix A Recommendations

Part A. Matters that should change

Recommendation 6

Administrators who wish to provide information to creditors other than in hard copy form should be required to send each notifiable creditor of a company an initial written notice that the company has gone into administration. The notice should indicate:

- where information regarding the holding of subsequent meetings, and documents for those meetings, can be obtained. At a minimum, the information sources identified in the written notice should be a toll-free telephone number to obtain written information free of charge and a designated website that will contain the information
- the statutory timeframes for holding further meetings and issuing information for those meetings.

Administrators who choose to provide this information should not be required to send creditors any further written information unless the creditors so request.

Note: This recommendation does not:

- affect the requirement in s 439A(3)(b) requiring newspaper notices
- apply in the context of pooling (see Recommendation 42).

Recommendation 7

As recommended in the 1998 VA report:

- the periods for holding the first and major meetings of creditors should be incrementally increased (namely, for the first meeting within 8 business days, and for the major meeting within 25 business days, of the appointment of the administrator), and
- the administrator should be permitted to hold the major meeting before the end of the convening period.

In addition, the court should have a specific power, on application by the administrator, to override the statutory timetable and to substitute a specific and comprehensive timetable for a particular administration.

Administrators should have the power to adjourn a creditors' meeting either to a specific date or a date to be notified within the specified statutory period.

Recommendation 10 (in part)

Within a prescribed period, administrators should be required to publish reasons for the way they exercise any casting votes.

Recommendation 15

Persons with adequate expertise and experience in corporate rehabilitation (whether or not they also have expertise and experience in liquidations) should be permitted to be administrators.

There should be no roster system for the appointment of administrators.

The court, on application by an eligible appointor, should have the power to appoint as administrator of a particular company a person who does not satisfy the eligibility criteria, if satisfied that the person's specific skills and experience are especially relevant to the activities of that company.

Recommendation 18

Administrators' remuneration should be able to be approved by:

- agreement between the administrator and a simple majority, by value, of the committee of creditors, or
- resolution of creditors generally (in accordance with the voting procedure in Corporations Regulations regs 5.6.19 and 5.6.21) where they have notice that this matter is to be considered, or
- the court.

Any approval by the committee of creditors should be effective only until the major meeting or any other general meeting of creditors. Creditors at a general meeting could prospectively, but not retrospectively, amend any remuneration agreement approved by the committee of creditors.

Recommendation 22

Deed administrators should have the power to sell or cancel existing shares in the company only with the approval of the shareholder or the leave of the court. Shareholders, creditors and ASIC should have standing to oppose a court application for leave.

Recommendation 24

The decision period for substantial chargees to appoint a receiver after receiving notice of the appointment of an administrator should be increased to 15 business days.

An administrator should be permitted to enter into an agreement with the substantial chargee within that decision period whereby the substantial chargee may appoint a receiver at any time during the administration, provided the committee of creditors (by simple majority by value excluding any vote by the substantial chargee) has granted that power to the administrator.

Recommendation 31 (in part)

A post-administration lender may be given a priority over all pre-administration unsecured creditors if that priority is approved by three quarters by value and a simple majority by number of those pre-administration unsecured creditors who vote on the resolution.

Recommendation 32

The committee of creditors should have the following additional powers:

- to approve administrators' fees on an interim basis (Recommendation 18), or
- to approve a substantial chargee continuing to have the right to appoint a receiver after the decision period (Recommendation 24).

Recommendation 34

The legislation should make clear that a corporation can be a member of a committee of creditors.

Recommendation 35

An administrator making an equity for debt offer should only be required to provide a statement setting out all relevant information that the administrator knows or ought reasonably to know (regardless of the size of the fair value of the debt involved) where that offer does not require accepting creditors to contribute any further consideration under that offer. The administrator's statement should indicate that it is not a prospectus and therefore may contain less information than a prospectus.

Recommendation 37

The legislation should make clear that all affected creditors are bound by an equity for debt swap in a deed of company arrangement.

Recommendation 39

It should be made clear that a deed of company arrangement is not invalid merely because it departs from the statutory winding up priorities. This recommendation does not take a particular position on the treatment of employee entitlements, to which special considerations may apply.

Recommendation 40

Pooling should be permitted where there is:

- a common ownership structure
- a common exposure to specific actual or contingent liabilities, or
- ownership or operation of corporate assets in a common scheme or undertaking.

Recommendation 41

Solvent group companies should be permitted to enter into an administration with other group companies where at least one of those companies satisfies the voluntary administration prerequisite.

Recommendation 42

Where no existing pool

The initial decision whether to pool should rest with the directors of any solvent group company, and the administrator of any other group company, in the proposed pool.

Where the directors or the administrator of a group company have decided to pool, they must:

- give written notice of that intention to all creditors of that company, together with:
 - a statement identifying the other group companies in the proposed pool

- a summary of all material information known to the directors or the administrator (as the case may be) that is relevant to the creditors' decision whether to object to the pooling of those group companies
- a statement of the right of any creditor to object, and the procedure for lodging that objection with the company.

The pooling may proceed provided:

- in relation to each group company in the proposed pool, no creditor of that company objects within a prescribed period, or the court confirms the pooling on the application of the company, notwithstanding that objection, and
- this procedure is satisfied for all the group companies in the proposed pool.

Unless all the group companies can participate in the proposed pool, the pooling cannot take place. The approval process would need to be repeated for any new pooling proposal.

Adding to an existing pool

A group company may join an existing group pool only if:

- that company complies with the above approval process
- the administrator of the existing pool agrees, and
- the creditors of the companies in that pool do not object (after being informed as above), or the court overrides their objections.

Recommendation 50

Paragraph 588FF(3)(a) should be amended by adding after 'within three years after the relation-back day' the following: 'or within 12 months after the date of appointment of the liquidator, whichever is the later'.

Part B. Matters that should not change

Recommendation 1

Voluntary administration, under which corporate control is transferred to an external administrator, should be retained. There is no clear case for introducing a debtor in possession regime based on Chapter 11 of the United States Bankruptcy Code, either as a substitute for voluntary administration or as an additional procedure.

Recommendation 2

The Business Turnaround model should not be adopted as either a substitute or additional rehabilitation procedure.

Recommendation 3

There is no need to change the current description of the Part 5.3A process.

Recommendation 4

The current prerequisites for entering into voluntary administration should be retained, including where the directors consider that ‘the company is insolvent, or is likely to become insolvent at some future time’.

Recommendation 5

There should be no change to the existing law concerning who may appoint an administrator.

Note: this recommendation supersedes Recommendation 44 of the 1998 VA report, which proposed that individual creditors be permitted to appoint an administrator with the leave of the court.

Recommendation 8

Creditors at the first meeting should not be given the power to extend the convening period for holding the major meeting.

Recommendation 9

Creditors at the first meeting should not be given the power to wind up the company.

Recommendation 10 (in part)

Voting in voluntary administrations should continue to be according to majority by value and majority by number of creditors.

Administrators should retain the right to exercise a casting vote in the event of deadlock of a vote by value and a vote by number of creditors. They should not be required to obtain an independent report before exercising their casting votes.

Recommendation 11

There should be no change to the court's current discretionary powers concerning VAs.

Recommendation 12

There should be no statutory timeframe for forwarding the draft deed to creditors before the major meeting.

Recommendation 13

There should be no solvency prerequisite for a valid deed of company arrangement.

Recommendation 14

There should be no legislative limit on the period during which a deed can remain in force.

Recommendation 16

The current time within which administrators must lodge notification of appointment or cessation (24 hours) should remain.

Recommendation 17

There should be no change to the current law regarding the circumstances in which ASIC may provide information to administrators.

Recommendation 19

Administrators should not be given the power unilaterally to assign or terminate contracts.

Recommendation 20

Administrators and deed administrators should not be given the right to void antecedent transactions.

Recommendation 21

There is no need for a specific provision empowering an administrator or deed administrator to issue shares in a company under administration.

Recommendation 23

There should be no change to the current position under which a substantial chargee can appoint a receiver after receiving notification of the appointment of an administrator.

Recommendation 25

Substantial chargees should not be given the power to exercise their rights over part only of their security.

Recommendation 26

The current indemnity rights of administrators should not be changed to take into account the appointment of a receiver.

Recommendation 27

There should be no obligation on receivers to postpone a sale of corporate assets.

Recommendation 28

There should be no change to the current position under which ipso facto clauses can be enforced.

Recommendation 29

There should be no change to the current position under which creditors can exercise set-off rights after the appointment of an administrator.

Recommendation 30

There should be no change to the current position regarding the operation of Romalpa clauses during an administration.

Recommendation 31 (in part)

A post-administration lender should not be granted any priority over any pre-administration secured creditor, except with the consent of that creditor.

There should be no change to the current law whereby administrators are not personally liable for loan finance obtained during the course of an administration.

Recommendation 33

There should be no regulation of the size or membership of a committee of creditors.

Recommendation 36

Equity for debt offers should not be exempt from the financial product disclosure requirements.

Recommendation 38

There should be no change to the current procedures for exempting equity for debt swaps from the takeover provisions.

Recommendation 43

Companies under administration should not be exempt by statute from the financial reporting requirements.

Recommendation 44

Companies under administration should not be exempt by statute from the annual general meeting requirements.

Recommendation 45

Companies under administration should not be exempt by statute from the requirement to have a minimum number of directors.

Recommendation 46

It should remain a matter for the administrator's discretion whether to renew any D&O insurance.

Recommendation 47

There should be no statutory provision permitting a deed of company arrangement to override a company's constitution.

Recommendation 48

There should be no change to the current law regulating transfers of shares in companies under administration.

Recommendation 49

There should be no change to the statutory requirement that only shareholders, by special resolution, can change the name of a company in administration.

Creditors' scheme of arrangement provisions

The Advisory Committee makes no recommendation in relation to these provisions.

Appendix B List of respondents

- Australian Accounting Research Foundation
- Australian Bankers' Association
- Australian Institute of Company Directors
- Australian Shareholders' Association Ltd
- Business Turnaround Association
- CPA Australia
- Richard Fisher of Blake Dawson Waldron
- Ron Harmer
- Insolvency Practitioners Association of Australia
- KordaMentha
- KPMG Corporate Recovery, Melbourne
- Law Council of Australia
- G R Putland
- Geoff Sutherland of Coudert Brothers
- The Institute of Chartered Accountants in Australia
- Leon Zwier of Arnold Bloch Leibler

Appendix C Summary of US Chapter 11

The Advisory Committee thanks Beatrice O'Brien, Director, New York Bar Review Pty Ltd, for her assistance in preparing this summary.

Prerequisites for initiating the procedure

A company may seek the protection of Chapter 11 of the US Bankruptcy Code by filing a petition in the Bankruptcy Court.

The Code does not have any financial stress or other prerequisite test for entry into Chapter 11. However, some US Bankruptcy Courts have imposed a 'good faith' requirement on applications for Chapter 11 protection. This can be used, for instance, to stop clearly solvent companies obtaining the protection of Chapter 11 simply to gain a debt holiday or some other commercial advantage.

The Courts may also at any time dismiss Chapter 11 proceedings if they consider that a company can neither reorganise nor provide a better return to creditors by the company's assets being sold over time.

Debtor in possession

A company that has gone into Chapter 11, known as a debtor in possession (DIP), retains control of its own affairs, though all or some of the incumbent board or other managers may be replaced.* The DIP can also choose to employ outside expertise, such as 'turnaround' professionals, to assist the rehabilitation.

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

While the board of the DIP must approve certain actions, for instance the filing of a plan of reorganisation, its role in a Chapter 11 proceeding is subject to the supervisory role of the Bankruptcy Court.

Role of the Court

The Bankruptcy Court is closely involved in the corporate reorganisation process under Chapter 11. For instance, its prior approval is necessary before a DIP may act outside the ordinary course of its business. Also, the Court can replace the board of the DIP with a trustee if it considers that the board has been fraudulent, dishonest or incompetent or has grossly mismanaged the company. Furthermore, creditors can challenge managerial decisions in Court or request the Court to appoint an examiner, whose role may include providing information to the Court or mediating disputes between parties in Chapter 11 litigation. Also, a reorganisation plan cannot proceed without the prior approval of the Bankruptcy Court.

Committee of creditors

The committee of creditors plays a vital and significant role in the Chapter 11 process. These committees are entitled to employ lawyers, accountants and other professionals to review the directors' proposals and, if necessary, their conduct. The costs of these experts are met from the company's assets. An active committee enables the DIP's creditors to have an effective voice in that company's reorganisation and to ensure that its managers remain accountable for their actions. The costs of these committees may be relatively more burdensome for smaller than for larger enterprises.

Personal liability of directors for insolvent trading

The board of the DIP retains control of the company throughout the Chapter 11 rehabilitation period, subject to the supervision of the Bankruptcy Court. However, the issue of director liability for insolvent trading does not arise in the US, which has no equivalent of the Australian insolvent trading provisions.

Automatic stay

The initiation of a Chapter 11 proceeding immediately freezes the rights of all creditors, secured as well as unsecured, as at that date. The freeze, known as the automatic stay, remains until the Chapter 11 proceedings are completed or the Court, after notice and a hearing, modifies that stay.

This automatic stay is one of the most important features of the US bankruptcy system. As a result, all creditors of the DIP are prohibited from taking any steps to collect on debts, even if that company has defaulted on its obligations. This freeze applies to all property of the DIP, including security previously seized by a secured creditor, but not yet sold by that creditor before the petition is filed. There is no equivalent of the Australian VA provisions permitting some secured creditors to exercise their proprietary rights, regardless of a VA.

There is a statutory prohibition on creditors enforcing ipso facto clauses, other than in limited circumstances. The right of set-off is preserved by the Bankruptcy Code, though it is subject to the automatic stay.

A secured creditor may seek to lift the automatic stay on the grounds that the value of its security is declining and that the DIP has failed to provide it with 'adequate protection'.

The reorganisation plan

In order to emerge from bankruptcy protection, a DIP must have its reorganisation plan confirmed by the Bankruptcy Court. The Court will consider whether each class of creditors has approved the plan. However, under the 'cramdown' section of the Bankruptcy Code, the Court may approve a reorganisation plan, despite the objection of one or more impaired classes of creditors, if at least one impaired class assents and the proposed plan is found by the Court to be 'fair and equitable' to any objecting class. A class is impaired if the plan would alter any of the legal rights of its members compared with their pre-Chapter 11 position.

The DIP's ability to effect a freeze or automatic stay on creditors' rights by commencing Chapter 11 proceedings, together with the

cramdown rules, enhance the opportunities for its management to negotiate with creditors at an early stage on the design of a reorganisation plan. Equally, however, secured creditors who choose to provide a company in financial distress with further financing may have considerable power over the future conduct of that company and the terms of any reorganisation plan through the terms and conditions they can impose on that funding.

Over time, the Chapter 11 process has become more settled, with rules that are widely understood and applied more uniformly. In consequence, debtors and creditors have increasingly negotiated reorganisation plans outside Chapter 11. This method of informal pre-Chapter 11 negotiation (known as a ‘pre-pack’) allows the debtor company to avoid the expense of seeking protection under Chapter 11. Typically, a pre-Chapter 11 reorganisation plan is implemented by a formal Chapter 11 filing.

Timetable

US Chapter 11 generally gives the DIP the exclusive right for four months to file a reorganisation plan, with another two months for it to be accepted by creditors. These periods may be, and are routinely, extended by the Bankruptcy Court.

The US legislation does not have any prescribed period of time within which the reorganisation plan must be completed.

Post-petition financing

The DIP may incur ordinary course debt without prior court approval. However, all post-petition financing must be approved by the Bankruptcy Court. In either case, the debt is an administrative expense and takes priority over unsecured pre-commencement debts.

Lenders may be unwilling to advance an unsecured loan to a DIP because of lack of priority. To overcome this, the Court has power, after notice to creditors and a hearing, to authorise a loan secured over any unencumbered assets of the DIP. The Court may even permit a loan that ranks equally with, or has priority over, the claims of existing secured creditors, provided that those secured creditors receive adequate protection.

The Bankruptcy Court can also grant a DIP the right to use as a security for a new borrowing excess value in any collateral that has already been pledged to another secured lender. The DIP must demonstrate that the prior secured lender is ‘adequately protected’ in that the amount of loan outstanding to that lender is substantially less than the total value of the collateral. The ‘cushion of collateral’ available for the new loan would be the difference between the value of the security and the lesser amount owed to the original security holder (being the principal plus any accrued interest).

Ipsa facto clauses

A DIP cannot be placed in default merely because it has filed for protection under Chapter 11. However, in limited circumstances, a counterparty may enforce rights arising in consequence of this filing. For instance:

- a lender to a company that goes into Chapter 11 can rely on an ipso facto clause to the extent of not having to provide further funds to the company, though it cannot accelerate repayments
- a person can rely on an ipso facto clause to terminate a contract for the provision of personal services (in comparison, a creditor providing goods to the company cannot rely on an ipso facto clause to refuse to supply further goods, but is entitled to immediate payment for any goods supplied while the company is under Chapter 11).

It also appears that US law allows anyone who has agreed to take up shares in a company that has subsequently gone into Chapter 11 to decline to do so, relying on an ipso facto clause.

Voiding antecedent transactions

A DIP may commence an action to recover payments made on account of antecedent debts prior to the commencement of the Chapter 11 proceeding. In addition, that company may commence an action to avoid certain fraudulent transactions. In certain circumstances, the committee of creditors may also seek to avoid certain transactions.

Assigning or terminating executory contracts

A DIP may assign an executory contract, regardless of its terms, provided that the contract is of a type that is generally assignable and the assignee gives appropriate assurances of future performance.

A DIP may also terminate an executory contract, regardless of its terms, with the counterparty having a corresponding claim.

Exchange listing

US listed entities subject to Chapter 11 can remain listed, and therefore their shares can be traded, on the stock exchange.

Comparative table

	VA	US Chapter 11
Prerequisites	Insolvency or likely insolvency.	Good faith only.
Who can commence the procedure	The directors, a liquidator or provisional liquidator or a substantial chargee.	The directors.
Role of the court in commencing the procedure and approving the plan	No mandatory role in either situation, though the court has various ancillary powers exercisable on application.	Procedure initiated by petition to the court. Continuing close court involvement in the rehabilitation procedure, including final approval of plan.
Who controls the company during the rehabilitation procedure	The administrator, who must be a registered liquidator.	Management, subject to court supervision. The court may replace management under certain, rare, circumstances.
Committees of creditors	Limited functions, namely to consult with the administrator in relation to the administration and consider reports by the administrator.	Major role. Can employ professional advisers at the company's expense.
Information to creditors	Report by the administrator about the company's business, property, affairs and financial circumstances and a recommendation about what is to be done.	Court-approved disclosure statement.
Moratorium on claims against the company	Automatic moratorium, with significant exceptions for some secured creditors and property owners.	Automatic moratorium, which applies to all secured and unsecured creditors.
Ability of contractual counterparties to enforce ipso facto clauses	Yes.	Only in limited circumstances.
Liability for goods and services	Administrator personally liable, with a right to an indemnity out of the company's assets.	Company liable for post-Chapter 11 debts, which have a priority over pre-Chapter 11 debts.
Loan financing during rehabilitation procedure	Lender is an ordinary unsecured creditor of the company.	The court can give a lender a priority over all existing unsecured creditors and, if necessary, over existing secured creditors.

	VA	US Chapter 11
Who devises rehabilitation plan	The administrator.	Management of the company, usually in consultation with professional advisers, proposes the reorganisation plan. That plan must be approved by the board prior to filing in the Bankruptcy Court. The court may allow any party-in-interest to file a reorganisation plan.
Voiding antecedent transactions	No.	Yes.
Unilateral assignment or termination of executory contracts	No.	Yes.
Time to develop rehabilitation plan	Approximately one month, subject to the court extending the period.	120 days to file a plan, subject to the court extending the period.
Approval of rehabilitation plan	One meeting of all creditors.	The reorganisation plan must be approved by at least one class of impaired creditors. If all classes of impaired creditors do not approve the plan, the court may still approve it if it is fair and equitable.
Majority required to approve the plan	50% majority by number and by value of all the creditors who vote.	Two-thirds in amount, and more than one-half by number, of creditors who vote, class by class. A dissenting class can be overridden by the 'cramdown' rules.
Rehabilitation plan binding secured creditors	Yes, if the secured creditor agrees or the court so orders.	Yes, provided: <ul style="list-style-type: none"> • if impaired class of secured creditors, at least one impaired class assents • the plan is fair and equitable.
Rehabilitation plan discriminating between creditors	The creditors can approve a deed that discriminates against particular creditors.	Under the 'absolute priority' rule, senior creditors are paid before junior creditors. All creditors are paid before shareholders. One class cannot receive less than another class with identical priority without the consent of its members.
Time to implement rehabilitation plan	No prescribed limit.	No prescribed limit.

Appendix D Comparison of VA and schemes of arrangement

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

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

Appendix E Advisory Committee and Legal Committee

Advisory Committee

Functions

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

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

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

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

Advisory Committee members

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

The members of the Advisory Committee are:

- Richard St John (Convenor)—Special Counsel to Johnson Winter & Slattery, former General Counsel of BHP Limited and Secretary to the HIH Royal Commission
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Barbara Bradshaw—Chief Executive Officer, Law Society Northern Territory, Darwin
- Philip Brown—Emeritus Professor, University of Western Australia, Perth
- Berna Collier—Commissioner, Australian Securities and Investments Commission (alternate to Jeffrey Lucy, Chairman, ASIC)
- Greg Hancock—Managing Director, Hancock Corporate Investments Pty Ltd, Perth
- Merran Kelsall—Company Director, Melbourne
- John Maslen—Chief Financial Officer and Company Secretary, Mitchell Australia Pty Ltd, Adelaide
- Louise McBride—Partner, Deloitte Touche Tohmatsu, Sydney
- Marian Micalizzi—Chartered Accountant, Brisbane
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, The Seidler Law Firm, Sydney
- Nerolie Withnall—Consultant, Minter Ellison, Brisbane.

Legal Committee members

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

The members of the Legal Committee are:

- Nerolie Withnall (Convenor)—Consultant, Minter Ellison, Brisbane
- Elspeth Arnold—Partner, Blake Dawson Waldron, Melbourne
- Ashley Black—Partner, Mallesons Stephen Jaques, Sydney
- Elizabeth Boros—Professor of Law, Monash University, Melbourne
- Suzanne Corcoran—Professor of Law, Flinders University, Adelaide, and Professorial Fellow, Australian National University, Canberra
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Brett Heading—Partner, McCullough Robertson, Brisbane
- Jennifer Hill—Professor of Law, University of Sydney
- Francis Landels—former Chief Legal Counsel, Wesfarmers Ltd, Perth
- Duncan Maclean—Special Counsel, Minter Ellison, Perth
- Laurie Shervington—Partner, Minter Ellison, Perth
- Gary Watts—Partner, Fisher Jeffries, Adelaide.

Executive

The Executive comprises:

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