RECENT DEVELOPMENTS

VOLUNTARY ADMINISTRATIONS: Is Reform Due?

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INTRODUCTION

The voluntary administration procedure contained in Part 5.3A of the Corporations Law (the Law) came into effect on 23 June 1993. The procedure enables an administrator to be appointed to take control of the affairs of a company that is unable to pay its debts, or is likely to become unable to pay its debts at some future time, and in appropriate circumstances for the administrator to implement subsequently a deed of company arrangement with the support of the company's creditors. Today, almost four years later, there have been 4614 voluntary administrations and 2051 deeds of company arrangement.[1] The large number of voluntary administrations entered into since the introduction of the legislation suggests that the procedure is being embraced in practice.

In the four years since the procedure has been in operation, considerable experience has been gained by administrators, creditors and legal practitioners involved in the administration process. If the procedure is to continue to be effective in the interests of companies and their creditors, the practical operation of the legislation should be reviewed periodically to ensure that it continues to serve the needs of those who rely upon it.

The criteria as to when a review of this legislation should be entertained are imprecise; one view is that a review should occur when sufficient commentators with experience in the operation of the voluntary administration procedure have made worthwhile contributions to the discussion of its operation. I believe that there have now been sufficient published contributions, culminating in the Discussion Paper of the Legal Committee of Companies and Securities Advisory Committee on proposed amendments to Part 5.3A,[2] that the time is now right for the legislators to stand back from their original design and determine whether further development or modification of Part 5.3A is necessary or desirable.

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1 Australian Securities Commission Insolvency Statistics – current as at 28 February 1997.

2 *Voluntary Insolvency Administration Discussion Paper*, Legal Committee, Companies and Securities Advisory Committee, January 1997.

I examine in this paper some instances where I believe reform of Part 5.3A is due. I also discuss several other instances where I regard the operation of Part 5.3A as adequate and, as such, believe that the legislation does not require amendment. My comments below are set against the background of the time line in which the voluntary administration procedure is conducted and in the context of the stated objective of the procedure enshrined in the Law.

THE OBJECTIVE OF THE VOLUNTARY ADMINISTRATION PROCEDURE

The voluntary administration procedure aims to provide a more flexible means of reviving a company or, if this is impossible, ensuring a better return to its creditors. Section 435A of the Law states that the objective of the voluntary administration procedure is:

> "to provide for the business, property and affairs of an insolvent company to be administered in a way that:
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> (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
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> (b) if it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company."

According to the Harmer Report,[3] the voluntary administration procedure was designed to be:

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

The Harmer Report found that a constructive approach to corporate insolvency requires the preservation, if practical and possible, of the property and business of the company in the brief period before creditors are in a position to make an informed decision. This assists in an orderly and beneficial administration, whether creditors decide to wind up the company or accept a compromise or some other form of arrangement.[4]

THE FIRST MEETING OF CREDITORS

The Current Position

Part 5.3A requires the administrator of a company under administration to convene a meeting of the company's creditors within five business days after the administration begins.[5] Creditors are to receive at least two business days' notice of the meeting.[6]

The purpose of the first meeting of creditors is to consider whether to establish a committee of creditors and, if so, to appoint the committee members.[7] The first meeting may also be used as

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3 Australian Law Reform Commission, *General Insolvency Inquiry* (Chairman, Mr R W Harmer) Report No 45, 1988, vol 1, para 54.

4 Harmer Report, vol 1, para 53.

5 Section 436E(1) and (2).

6 Section 436E(3).

7 Section 436E(1).

the forum for creditors to resolve to remove the appointed administrator and to appoint another administrator.[8]

The Business of the First Meeting

The first meeting is an essential element of the voluntary administration procedure and should be retained. Put properly in context, it is the first formal occasion on which the creditors come together with the administrator of the company.

The business of the first meeting, as presently contemplated by the Law, is minimal. In my experience the first meeting has been used on an informal basis for a much broader range of matters by both administrators and creditors, including the following:

(a) The administrator may explain all of the relevant circumstances leading up to the administrator's appointment, including the nature of the administrator's involvement (if at all) in the process leading to his or her appointment.

(b) The administrator may give the creditors present an oral overview of the voluntary administration procedure (including particularly the tasks the administrator will be undertaking) and the opportunity to raise any queries either about the procedure or their rights thereunder. The creditors thereby receive at an early stage a good working knowledge of the procedure and their rights vis-a-vis the company. I comment further about this matter later in this paper.

(c) The administrator may outline the extent of the investigations proposed to be undertaken to advise the creditors of the return to them on a liquidation scenario, taking into account such matters as the benefits flowing from voidable transactions the actions against directors and other persons associated with the company. The first meeting may then be used as a forum at which any issues or concerns by creditors about the company's conduct prior to the appointment are raised for the administrator to note and consider subsequently. The administrator may obtain useful information in this way that may not be available freely through the directors and management of the company.

(d) The meeting may be used as an opportunity for the administrator to present any initial, albeit qualified, observations about the state of the asset and trading position of the company and the extent of the work to be undertaken to enable a detailed report about the financial position to be issued for the purposes of the second meeting. While the administrator, understandably, may be reluctant to present a definitive position to creditors about the financial position at the date of the appointment (particularly if the administrator does not have by that time the benefit of a duly completed statement by the directors about the company's business, property, affairs and financial circumstances),[9] creditors are invariably anxious to have some general appreciation of these matters before leaving the first meeting.

(e) An administrator may give creditors preliminary observations about the options the administrator is considering regarding the future direction of the company and, if the circumstances are appropriate, an early indication of the administrator's likely preferred option. In all but the more complex administrations it would be surprising if, after five business days, those options had not crystallised sufficiently in the administrator's mind to give the creditors some general comments on this topic. In that context, the administrator will usually have had some involvement with the company before his or her appointment and will have sighted some preliminary assessment of the company's financial position as a pre-requisite to accepting the appointment. The administrator may also tell creditors of the

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8 Section 436E(4).

9 Section 438B(2).

extent of the work involved to enable the administrator to make an informed recommendation to creditors in his written report.

(f) The administrator may indicate whether it is his or her present intention to trade all or part of the company's business during the administration period and what factors might influence an alteration of that position at short notice.

(g) The administrator may indicate whether there are any peculiar circumstances which might require an urgent sale of the business or undertaking of the company as a going concern before the second meeting (albeit on the basis that the sale was conditional on creditor approval at the second meeting).

Based on my experience of what happens in practice, I consider that the business of first meeting should be re-orientated such that its primary focus be changed to the matters listed in sub-paragraphs (a) - (g) above; the appointment of a committee of creditors and the option of removing the administrator should remain as part of the business of the meeting. Section 436E should be amended accordingly.

In this way, consistent with the underlying objective of Part 5.3A, the administrator gives the creditors an early information flow, albeit oral and in some aspects preliminary in nature. The creditors are then better placed to come to the second meeting with some confidence that they know the processes which have been conducted to enable the administrator to make his recommendations to creditors about the future direction of the company. There is also less likelihood that the second meeting (when the real decisions have to be made) will be diverted by emotive creditors and by questions about matters which the administrator may not have investigated prior to the meeting simply because they had not previously been raised for consideration.

While I am recommending a greater degree of information flow at the first meeting, in my opinion it is impractical and unnecessary for creditors to be provided with a specific written report prior to, or at that meeting, about all of the matters in sub-paragraphs (a) - (g) above in so far as they apply to the circumstances of the particular company under administration. To require the administrator to do so may well distract the administrator from his or her investigative role and add unnecessary costs to the administration.

Eligibility and Removal of the Administrator

At the first meeting it is open to creditors to resolve to remove the appointed administrator and appoint someone else as administrator.[10] The resolution to remove an administrator is not limited to a consideration of whether the original appointee is disqualified from acting in that capacity by reason of section 448C.

In every administration creditors invariably start from a position of being wary that there is some existing relationship between the administrator and the directors or shareholders of the company. One of the early tasks facing the administrator is to build confidence in the creditors that the administrator is truly a neutral party acting dispassionately in the interests of all creditors. Only once the relationship between the administrator and the creditor stabilises will the creditors be in harmony with the administrator.

For this reason, I consider it should be a mandatory requirement of the Law for the administrator to send out with the notice to creditors a statement confirming that he or she has not been in any of the relationships or roles set out in section 448C(1) and as such is not disqualified from acting as administrator. The administrator should also deal with the issue again orally as part of the business of the first meeting and at the meeting supplement the material accompanying the notice

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10 Section 436E(4).

with a report as to the administrator's involvement in the process leading to his or her appointment.

Further, to minimise frivolous or unfounded challenges, a provision should be inserted into section 436E requiring a creditor to cite all of the creditor's reasons for challenging the appointment of the administrator before proposing a resolution that the administrator be removed.

The Time for Holding the First Meeting

Given the business of the first meeting (as occurs currently both formally and informally), I see no justification for extending the date by which the meeting is to be held, particularly if it were also to lead to slippage in the date for the holding of the second meeting. Any extension of the time for convening the first meeting is unlikely to facilitate tangible benefits for creditors particularly in the context of there being a moratorium on creditors' rights.

The fact that some administrators have logistical difficulties in despatching notices to some creditors can be overcome in many instances with better practice management; persons who regularly accept appointments as administrators know beforehand the time constraints imposed upon them by the Law and should be focused, both immediately prior to and after their appointment, on sending the notice of the first meeting to creditors.

Creditors' Knowledge of the Procedure

The Law should prescribe matters relating to the voluntary administration procedure which the administrator should be required to address in his or her oral report to the creditors at the first meeting. By prescribing those matters there would be greater certainty that all of the key features of the procedure were being addressed with creditors in the context of every administration.

The key features of the voluntary administration procedure which ought to be pointed out to creditors at the first meeting include:

(a) that the administrator has control of the company's business, property and affairs to the exclusion of the directors;

(b) that the administrator may perform any function and exercise any power that the company or any of its officers could perform if the company were not under administration;

(c) the nature and extent of the moratorium on the rights of creditors, owners and lessors of property in the possession of the company;

(d) the timetable in which the administration must be completed under the Law;

(e) the general nature of the tasks which the administrator is obliged to undertake under the Law;

(f) the right of creditors to control the future course of the company by voting at the second meeting that the company execute a deed of company arrangement, be placed into liquidation or be handed back to the directors;

(g) the rights of persons dealing with the company during the administration period who sell goods and services to the company;

(h) the role of the committee of creditors, if one were to be appointed, and the likely time commitment required of the committee during the period of the administration.

The administrator, being a person expected to be thoroughly conversant with Part 5.3A, is in the best position to ensure that creditors have a proper understanding of all these matters. In many

instances creditors will be able to avoid the need to incur unnecessary costs in appointing other professionals to give them the same information.

The Insolvency Practitioners' Association of Australia has recommended to its members that, at the time of sending to creditors the notice convening the first meeting, they should enclose a copy of the Associations' Guidelines, issued on 9 December 1993 in conjunction with the Australian Securities Commission, outlining the rights of creditors in various insolvency administrations. It is implicit in this recommendation that it would be advantageous to creditors to have early information about those matters. The rights of creditors are, however, only one of a number of important matters to which I refer in this section of the paper about which creditors should have early notice. All of the matters set out above concerning the voluntary administration procedure should be dealt with orally at the first meeting; although, in principle, there is no reason why the procedural matters could not be reduced to writing with the legislation prescribing that the creditors be given that information with the notice of the first meeting. That is no substitute, however, for dealing with the matters orally at the meeting.

Composition of the Committee of Creditors

The Explanatory Memorandum to the Corporate Law Reform Bill 1992 states that the role of the committee of creditors is to liaise with the administrator as a means of ensuring that creditors are kept fully informed during the administration.[11]

The functions of the committee of creditors are to:

(a) consult with the administrator about matters relating to the administration; and

(b) receive and consider reports by the administrator.[12]

There are presently in the Law neither any restrictions imposed on, nor guidance given to, the administrator and the creditors as to the degree of diversity of creditors' interests to be represented on the committee.

In practice, administrators use the committee of creditors as a litmus for determining the future direction of the company, and particularly whether a deed of company arrangement, if proposed, would be likely to be acceptable to the creditors as a whole. It follows that the committee, if properly structured, should represent as broad a spectrum as possible of the different categories of the company's creditors.

It needs to be recognised that, depending on the business of the company, particular categories of creditors will have different commercial leverage in the structuring of any deed of company arrangement. Also, particular creditors within a category (by reason of the size of their claim, or for some other special reason) may have peculiar leverage. If that leverage is not recognised in the structure of the deed of company arrangement proposed for consideration by creditors at the second meeting there is real potential either for the creditors not to approve the deed, or if it is approved by the requisite majority, for the deed not to operate effectively, thereby leading to an early termination.

If the committee is broadly representative of the general body of creditors, then the fact that one or some of the members of the committee are self-interested (either individually or on behalf of a category of creditors) in pursing the formulation of a deed of company arrangement should not be, or be seen to be, detrimental either to the proper functioning of the committee or the due exercise of the voluntary administration procedure. In the end the administrator must be satisfied that the deed, if approved by the requisite majority, would not be overturned on the basis that any of its

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11 Para 467.

12 Section 436F(1).

provisions were oppressive or unfairly prejudicial to, or unfairly discriminatory against, one or more of the creditors or contrary to the interests of the creditors of the company as a whole.[13] This no doubt will not be lost on the committee when the administrator considers with them the overall structure of the deed.

It is therefore not only desirable, but imperative, that an administrator, when calling for the appointment of a committee of creditors at a first meeting, is active in promoting nominees who represent a broad spectrum of the different categories of creditors. In this context, the administrator should be given express power in the Law to co-opt creditors to the committee either at or after the first meeting (upon the requisite consents being obtained) to ensure that the committee is effective in its consultative role.

INVESTIGATION OF AFFAIRS AND CONSIDERATION OF POSSIBLE COURSES OF ACTION

The Current Position

As soon as practicable after the administration of a company begins, the administrator must:

(a) investigate the company's business, property, affairs and financial circumstances; and

(b) form an opinion about each of the following matters:

(i) whether it would be in the interests of the company's creditors for the company to execute a deed of company arrangement;

(ii) whether it would be in the creditors' interests for the administration to end;

(iii) whether it would be in the creditors' interests for the company to be wound up.[14]

Accompanying the notice convening the second meeting of creditors must be a report and a statement from the administrator setting out his or her opinion about each of those matters and his or her reasons for those opinions.[15]

In investigating the matters required to be dealt with to form the opinions referred to in sub-paragraph (b)(i) and (b)(iii) above, and to make the statement to creditors which accompanies the notice, it is implicit that the administrator must be able to justify, as far as possible, on objective criteria, why it is in the creditors' interests to pursue one course rather than the other.

In this context, if information given to the creditors by the administrator in a report or statement under section 439A about the company's business, property, affairs or financial circumstances were misleading and could reasonably be expected to have been material to creditors in deciding whether to vote in favour of a resolution that the company execute a deed of company arrangement, the court may make an order terminating the deed.[16]

Invariably creditors expect that as a result of the administrator's investigations they will receive a "bottom line" assessment effecting a comparison between the amount they will receive in relation to their debt or claim under a deed of company arrangement and the dividend they will receive in a liquidation of the company. Creditors have more recently come to expect that the administrator

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13 Section 445D(1)(f).

14 Section 438A.

15 Section 439A(4).

16 Section 445D(1).

may be unable to give them an indication of an exact amount under each scenario but rather only a comparative range of figures.

The Liquidation Scenario

An administrator faces not insignificant difficulties in assessing the return to creditors in a liquidation scenario. Some of the factors which cause those difficulties are set out below.

(a) The administrator may not have the opportunity to obtain sufficient evidence to verify and quantify creditors' claims, particularly if those claims are future or contingent, or claims for damages.

(b) The realisation values of assets may be uncertain.

(c) There may be claims by the company in liquidation against the present or former directors or officers for breach of their fiduciary or statutory duty (including insolvent trading) or breach of trust.

(d) There may be claims against parties dealing with the company in relation to voidable transactions which, if successful, might result in property being re-transferred, or payments disgorged, to the company.

(e) There may be claims for damages by the company against third parties arising out of commercial transactions in which the company is or was involved.

The Administrator's Obligation

The Law is silent as to the extent to which the administrator is required to pursue his or her investigations about some or all of these matters to enable him or her to form an opinion about the return to creditors in a liquidation scenario.

In so far as the circumstances of a company suggest that the return to creditors will be influenced by the pursuit of proceedings, the administrator has the unenviable task of having to determine what level of investigation should be carried out, with or without the assistance of solicitors, to form a view about the prospects of success of any court action that might be taken by a liquidator.

In many instances, legal advice (with its associated costs) is invariably necessary to enable the administrator to marshal the facts, determine the legal principles and consider the merits. Invariably, any opinion which an administrator reaches regarding the merits, albeit assisted by his or her solicitors and counsel, will be of a preliminary nature and must be appropriately qualified (particularly where not all relevant documentation has been sighted and reviewed and material witnesses interviewed). Legal advice is invariably necessary to enable the administrator to form a view about the solicitor and client costs that will be incurred to pursue the claim, the party and party costs that would be recoverable and the provision that would need to be made by the liquidator to pay the costs of the proposed defendant if the claim were unsuccessful and, in some cases, to provide security for those costs. Similar considerations regarding appeal hearings would also need to be factored into the equation along with such matters as the prospect of the defendant having sufficient funds to pay any judgment debt. The administrator may need to consider the impact of obtaining funding from an entity in consideration for that entity receiving an agreed percentage of the funds recovered from the defendant.

In short, the administrator faces a dilemma. On the one hand, the administrator appreciates that if the creditors are to be put as far as possible in a position to make an informed decision at the second meeting on the future direction of the company they should have sufficient information about the prospects of success in such proceedings. On the other hand, an administrator is conscious that creditors' funds will be dissipated the more investigations are pursued to enable meaningful views to be crystallised, particularly in circumstances where the administrator's opinion is that a deed of company arrangement is the preferred option. Alternatively, the

administrator may find that he or she is being pressed by a creditor to conduct investigations which may well be considered by the administrator to be unreasonable, but does not want to attend the second meeting without having a substantive response to the creditor in case it incites other creditors to raise concerns (albeit perhaps unwarranted) about whether the administrator's recommendations are influenced by his or her relationship with the directors.

All of these matters lead me to the conclusion that there should be an amendment to section 438A. The obligation imposed on the administrator in section 438A should be reframed such that the administrator is required to conduct such reasonable investigations as are practicable in the circumstances of the administration having regard to:

(a) the nature of the information reasonably at his or her disposal;

(b) the funds at his or her disposal;

(c) the comparative benefits to the creditors as a whole in conducting the investigations;

(d) whether in all the circumstances the investigations are unduly onerous; or

(e) any other good reason.

If the administrator, for whatever reason, is unable or considers it inappropriate to commence or exhaust his or her investigations in relation to a particular matter, it should be mandatory for the administrator to state fully in his or her report to creditors:[17]

(a) the scope of the investigations conducted;

(b) the investigations that were not conducted or concluded;

(c) the reasons why investigations were not conducted or concluded;

(d) the impact which the incomplete investigations (or the investigations not conducted) may have on the creditors' capacity to make an informed decision about whether it would be in the creditors' interests for the company to be wound up.

An appropriate amendment to Part 5.3A would need to be made to impose this requirement. In addition, consequential amendments would be required to section 445D to make that provision operate in harmony with the proposed amendments.

There should also be an amendment to Part 5.3A to enable an administrator to pursue such further investigations beyond those which he or she considers are reasonable in the circumstances of the company, if requested to do so by a creditor and on the basis that the expenses of those investigations are funded solely by that creditor. It would be necessary also for the court to be empowered under Part 5.3A to make such orders as it considers just with respect to the reimbursement of those expenses.

By the Law prescribing these matters, creditors in various administrations can expect greater consistency in the information provided to them for the purposes of their deliberations at the second meeting. These amendments which I advocate provide a sensible balance between the difficulties which the administrator faces in the discharge of his or her obligations to investigate the affairs of the company and the level of disclosure which creditors require to make an informed decision.

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17 Section 439A(4)(a).

DOCUMENTATION SENT TO CREDITORS WITH THE NOTICE CONVENING THE SECOND MEETING

The Current Position

The administrator convenes the second meeting by giving notice of the meeting to as many of the company's creditors as reasonably practicable and by causing publication of the notice.[18]

The notice given to a creditor convening the meeting must be accompanied by a copy of:

(a) a report by the administrator about the company's business, property, affairs and financial circumstances; and

(b) a statement setting out the administrator's opinion about the various matters referred to above which he is required to investigate; and

(c) if a deed of company arrangement is proposed a statement setting out details of the proposed deed.[19]

The Harmer Report recognises that if creditors are better informed, the second meeting is more likely to be productive and its proceedings more intelligible to creditors. Creditors also will be able to make a rational decision whether to attend the meeting.[20]

The Administrator's Report

The administrators' reports to creditors which I have sighted vary significantly in quality and content. This has an impact on the creditors' capacity to appraise fully the options available to them; the quantification of that impact is necessarily subjective.

The legislators can eliminate some of that impact, and take responsibility for improving the quality of the reports to creditors, by prescribing a list of matters which administrators should address in the reports. I am not an advocate of the report having to be set out in a prescribed form; it is sufficient if administrators are provided with a list of matters that should be addressed.

The argument against this view is that the administrator has a duty to ensure that the report is not false or misleading and, in that respect, should in any event be giving full disclosure to the creditors of all matters which are material to their considerations at the second meeting. I place a low weighting on the merits of such an argument as I consider that there is a greater imperative for the legislation to provide direction to administrators who cover the broad range of professional capabilities.

If it is accepted that creditors should be well informed, then I ask, rhetorically, what downside is there in providing administrators with legislative guidance about matters to be included in their report, in circumstances where the report is undoubtedly one of the cornerstones of the operation of Part 5.3A? I say this particularly if the legislation were to prescribe that the list is not exhaustive and is subject to the overriding requirement that it be supplemented by such information as may be necessary to ensure that creditors are given full disclosure of all matters relevant to their consideration of the business of the second meeting. It should not be left to the responsibility of interested professional bodies to opine on appropriate guidelines. Those professional bodies

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18 Section 439A(3).

19 Section 439A(4).

20 Harmer Report, vol 1, para 111.

invariably will have differing views, which administrators will need to assess in their quest for guidance (and inspiration).

Careful consideration needs to be given to the structure of the list to ensure that it is designed in such a way to promote consideration of the topics in a logical sequence. In that context I consider the legislation should prescribe (perhaps in the Regulations) that the following list of matters be addressed by the administrator in his or her report:

(a) the history of the company;

(b) details of the company's business activities;

(c) the recent trading performance of the company;

(d) the circumstances leading to the administrator's appointment;

(e) the assets and liabilities of the company at the date of the administrator's appointment;

(f) the return to creditors in a liquidation scenario;

(g) each of the matters set out in section 444A(4) and any other material terms of any deed of company arrangement;[21]

(h) the return to creditors under the deed of company arrangement;

(i) the comparative return to creditors under the liquidation and deed of company arrangement scenarios;

(j) any other material matters relevant to the administrator's deliberations in making the statement required under section 439A(4)(b);

(k) such other information as may be necessary to ensure that the creditors have full disclosure of all matters relevant to their consideration of the business of the second meeting; and

(l) the statement prescribed by section 439A(4)(b).

In relation to the part of the report dealing with the return to creditors in a liquidation scenario (see sub-paragraph (f) above) the amending legislation should further prescribe that the administrator set out in his or her report the following matters:

(i) the basis for his or her determination of the realisation values of assets;

(ii) the scope of investigations conducted to determine whether:

(A) the company has any claims against present or former directors or officers for breach of duty;

(B) there are any voidable transactions;[22]

(C) there are any claims against third parties arising out of commercial transactions in which the company is or was involved;

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21 The statement referred to in section 439A(4)(c) presently requires "details" of any proposed deed of company arrangement.

22 This is currently a requirement imposed on an administrator under Corporations Regulation 5.3A.02.

(iii) an estimate of the costs involved in pursuing each of the claims referred to in (ii) above and the costs of the defendants for which provision should be made if the claims are pursued and are unsuccessful;

(iv) the extent to which the known liabilities of the company have been verified;

(v) (without limiting (iv)), the investigations conducted to ascertain the nature and extent of any claims against the company which are future or contingent, or claims for damages that would crystallise on a liquidation;

(vi) any investigations that were not conducted or concluded and the reasons why the administrator took that decision; and

(vii) the impact that any incomplete investigations (or investigations not conducted) may have on the creditors' capacity to make an informed decision about whether it would be in their interests for the company to be wound up.

Information Relevant to Any Proposed Deed of Company Arrangement

Section 439A(4)(c) should be amended to prescribe that the administrator provide either the proposed deed of company arrangement or a statement by the administrator.[23] This amendment reflects no more than current practice.

Further, the statement should contain each of the matters set out in section 444A(4) and any other material terms of the deed that should be known by creditors. I regard the proposed amendments to section 439A(4)(c) as necessary. I have seen a wide variation in the quality and content of information provided by administrators in their statements to creditors under section 439A(4)(c).

While the legislation recognises that a deed of company arrangement might not be capable of being drafted in the short time frame available to the administrator before the despatch of his or her report to creditors, appropriate legislative safeguards should be in place to ensure that at least all of the material terms of the deed have been considered and determined by the administrator by the date of despatch of the report.

Unless all of the material terms are included in the report (assuming the deed cannot be enclosed with the notice convening the second meeting) there is a risk that creditors may vote in favour of a deed without making a fully informed decision. This is of particular concern where the statement does not give, for instance, sufficient details of the debts or claims of creditors which are to be regulated by the deed.

THE SECOND MEETING OF CREDITORS

The Current Position

The administrator must convene a second meeting of the company's creditors by sending a notice to creditors and publishing the notice in a newspaper, within 21 days following the administrator's appointment.[24] The period is extended to 28 days if the administration begins in December or on

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23 Currently the obligation is to provide only a statement.

24 Sections 439A(3) & (5).

a day less than 28 days before Good Friday.[25] The meeting must be held within 5 business days after the end of the convening period.[26]

At the second meeting, the creditors must decide on the company's future. Based on the administrator's report and opinion in the statement and the details of any deed of company arrangement provided to them by the administrator, the creditors may resolve that the company should execute a deed of company arrangement, that the administration should end, or that the company should be wound up.[27]

The Time for Convening the Second Meeting

Where the administration is a particularly complex one (because of the size of the company's business and operations or the principal terms of a deed of company arrangement are still being settled), the administrator may seek an extension of time from the court to convene the second meeting. Such relief should be granted by the court sparingly. In deciding whether to grant an extension the court must balance the objective of allowing the creditors to decide the company's future as soon as practicable with the need for the creditors to be given the benefit of a report (and, where appropriate, a proposed deed of company arrangement) from the administrator that will allow them to make an informed decision. The cost to creditors of prolonging the administration and the fact that the voluntary administration is only a temporary moratorium on creditor's rights are other considerations for the court.

It has been suggested that the quality and extent of the administrator's investigation may be jeopardised by the tight time frame. However, in response to such suggestions, the Harmer Report states that "the procedure should be expeditious and the period during which the moratorium may apply to creditors without leave of the court should not be extended further".[28]

An extension of the period in which the second meeting is to be held has potential to jeopardise the attainment of the objective of Part 5.3A in that it may lead to an increase in the costs of the administration and promote an environment where an investigation of the company's affairs may proceed on a less diligent basis. The fact that the administrator is personally liable for debts he or she incurs during the administration is also an incentive to convene the second meeting as soon as possible.

Given the existence of an avenue of relief from the court, to be granted only in appropriate circumstances, I see no justification for amending the legislation to extend the period for convening the second meeting.

The Time for Holding the Second Meeting

I recommend certain amendments to section 439A(2). In my view, the time at which the second meeting is held should be determined by whether the administrator has sent with the notice convening the meeting the form of the proposed deed of company arrangement or a statement setting out details of the proposed deed.

In the former instance the meeting should be convened within the period of 5 business days after the last day of the convening period (ie 21 days after the date of appointment of the administrator), consistent with the current legislation.[29]

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25 Section 439A(5).

26 Section 439A(2).

27 Section 439C.

28 Harmer Report, vol 1, para 108.

29 Section 439A(2).

However, in the latter instance the legislation should be amended to prescribe that the date for the meeting be extended to 7 business days, coupled with a requirement that the draft form of the deed be made available to creditors for inspection at the administrator's office not less than 1 business day before the date of the meeting and, on the day of the meeting, at the place set out in the notice at which the meeting is to be convened.

Failure on the part of the administrator to provide a draft of the proposed deed for inspection by creditors at or prior to the meeting should not invalidate the meeting, but rather be a ground on which the meeting may be adjourned by resolution of the creditors. In this way creditors will have a reasonable opportunity to consider not only the administrator's report and statement expressing his or her opinions, but also (if a majority so determine) the proposed deed of company arrangement, before being asked to vote on the future direction of the company.

With the benefit of precedents that have been developed over the past four years and the prescribed provisions set out in Schedule 8A to the Corporations Regulations, I consider that six business days after the despatch of the notice convening the second meeting is ample time to prepare a deed of company arrangement in all but exceptional circumstances. The basic structure of a proposed deed is usually settled by the administrator and any committee of inspection several days prior to the despatch of the administrator's report to creditors. The administrator's solicitors effectively have more than 6 (and possibly as many as 10 to 12) business days to prepare the deed.

Adjournment of the Second Meeting

The second meeting of creditors, once convened, can be adjourned from time to time, provided the adjourned meeting does not take place more than 60 days after the first day on which the meeting was held.[30]

The creditors may resolve to adjourn the meeting for many different reasons, including to enable the administrator an opportunity to draft amendments to the proposed deed which were settled in principle during the second meeting. Other reasons for the adjournment may be to allow the administrator to hold discussions with interested third parties who might be in a position to influence the effectiveness of the deed.

While I advocate the retention in the legislation of the ability to adjourn the second meeting, I am concerned that adjournments without the leave of the court should only occur within a period of 20 business days after the first date on which the second meeting was held. The administrator should retain the right to seek the approval of the court (based on proper supporting material) for such further extensions as the court might allow for a period or periods expiring no later than 60 days after the first day on which the second meeting was held. This position presents a balance between the need for the creditors to have some flexibility in dealing with the business of the second meeting in an efficient manner and the need to ensure that the moratorium on creditors' rights does not extend unnecessarily.

Attendance of Directors at the Second Meeting

The directors have certain obligations under the Law to attend on the administrator at such times and give the administrator such information about the company's business, property, affairs and financial circumstances as the administrator reasonably requires.[31] A director must not, without reasonable excuse, fail to comply with this obligation.[32]

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30 Section 439B(2).

31 Section 438B(3).

32 Section 438B(4).

The Law is presently silent as to whether the administrator is entitled to invoke section 438B(3) to require the directors to attend the second (or first) meeting of creditors and answer specific questions directed to such matters as the circumstances leading up to the administrator's appointment and the general trading history of the company over more recent times. It is unclear whether the "reasonable excuse" test can be used by a director to refuse to answer questions on the ground that the answers might incriminate that person.

I consider there should be an amendment to Part 5.3A to clarify the position. For my part, I think it would be an over-reaching of the legislation if directors, already under a positive duty to prevent insolvent trading (and who are thereby encouraged to utilise Part 5.3A in the interests of the company and its creditors), are not given some legislative protection to safeguard them against questioning at a creditors' meeting on matters concerning their personal liability for breach of duty. A creditors' meeting is not the appropriate forum for those matters to be addressed in any meaningful way. Further, while it should not be compulsory for directors to attend the second meeting of creditors, the directors should not be precluded from attending, answering questions and supporting the administrator's recommendation.

The Availability of the Deed of Company Arrangement

I am aware of instances where administrators have been reluctant to make copies of the executed deed available to creditors or persons dealing with the company. Persons interested in the company should be entitled to know the impact (if any) which the deed has on their relationship with the company and should have ready access to the deed for the purpose of considering their legal and commercial positions.

I accordingly consider that the Law should prescribe that once a deed of company arrangement is finalised and executed, all creditors of the company (irrespective of whether their rights are affected by the deed) and all persons dealing or contemplating dealing with the company during the period of the deed should be entitled to receive a copy of the deed from the administrator upon payment of a prescribed fee.

CONCLUSION

This paper is obviously not intended to deal with the full ambit of possible amendments to Part 5.3A. I have dealt instead with a range of issues focusing generally on the theme of providing further disclosure to creditors as part of the administration procedure. I regard full disclosure to creditors as one of the cornerstones to the successful operation of Part 5.3A.

There is some concern amongst commentators that as a large percentage of voluntary administrations have resulted in liquidations, the objective of Part 5.3A is not being met. I do not share that concern. The Harmer Report does not suggest that the voluntary administration procedure will result in the salvation of all failed companies. Rather, it states that the adoption of the procedure will be worthwhile if it provides better opportunities to salvage even a small percentage of companies which, under the old insolvency regime, had no effective alternative but to be wound up.[33]

I regard Part 5.3A as being a success story in the history of Australian insolvency management. It has been embraced in practice and, because of its flexibility, it serves well both creditors and companies in administration in a time frame that gives all interested parties a realistic opportunity to achieve commercial solutions.

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[33] Harmer Report, vol 1, para 53.