CORPORATE INSOLVENCY

Voluntary Administrations: The Good, The Bad and The Ugly

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THE OBJECT

The operation of Part 5.3A of the Corporations Law, Voluntary Administration, commenced on 23 June 1993. It provided a procedure for the administration of a company which was insolvent or which faced imminent insolvency, other than immediate liquidation.

The impetus for reform and the enactment of Part 5.3A came from the Australian Law Reform Commission whose report, following its enquiry into insolvency laws, the Harmer Report, recommended a change of focus and for an attempt to be made to preserve "the property and business of the company for a brief period so creditors will be in a position to make a more informed decision."

The object of Part 5.3A is expressed, in section 435A to be:

> "... 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."

You will observe that no reference is made in section 435A to the preservation of the business, property and affairs of the directors of an insolvent company, nor to the avoidance of liability of directors for insolvent trading. Yet sadly, there is now more than anecdotal evidence that for many in the "insolvency industry" this has become the prime object of Part 5.3A.

There have, however, been some spectacular successes achieved by voluntary administrators utilising the framework provided by Part 5.3A, who have shown that when the stated object of the Part is the main focus of the administrator and the influential stakeholders, huge benefits may be derived by all participating stakeholders.

THE GOOD: A CASE STUDY OF THE PROUDS-GOLDMARK ADMINISTRATION

Partly because to date, the administration of the Universal Retailers Group (URA) comprising, the Prouds, Goldmark and Edments retail jewellery chain, was an administration of a group of companies with the largest turnover under Part 5.3A since its enactment, and partly because I was privileged enough to be acting, with a number of my partners, for the administrators of URA, Ian Ferrier and Andrew Love, I propose to provide a brief overview of the administration to show just what can be achieved for an ailing business by a rigorous yet commercial application of the relevant provisions of Part 5.3A.

The Background to the Appointment of the Administrators

At the time of the appointment, the URA Group operated 193 stores nationally, had an annual turnover in excess of $200 million and employed approximately 2,000 staff. URA controlled approximately 13% of the national retail jewellery market, its next biggest competitor, Angus & Coote, holding a market share of 6%.

Since early 1990, the retail jewellery market has been depressed and Christmas sales in 1990 recorded a 17% decline on the preceding year. During the seven years between 1988 to 1995 the national retail jewellery sales market had grown by less than 1%. However during this same period, the number of jewellery retailers had increased, as a result of which the industry had become discount based.

There was also significant rental growth during this period, and most retailers experienced rental increases far exceeding their growth in sales. With poor trading conditions and increasing overheads, the URA Group was unable to service its growing debt. On 21 December 1995 the first secured lender's facility matured. The directors had, since early 1995, attempted to implement a restructure of the Group and to refinance its existing debt, including the debt owed to the first secured lender. These attempts proved unsuccessful and by 21 December 1995, the Group was unable to meet payment of the first secured lender's facility. As a result of this, the directors formed the opinion that it was necessary to appoint voluntary administrators.

The appointment was made at about 8.00 pm on 21 December 1995, three trading days before Christmas and at the most critical trading period for the URA Group. Historically, the Group had generated 40% of annual sales in the months of November, December and January, even though post Christmas sales reduced gross profit levels. Furthermore, all of the suppliers to the URA Group were, at Christmas, exposed to the maximum amount having supplied substantial amounts of stock during this peak trading period for the Group.

Balancing the Interests of the Stakeholders

The administrators' initial and prime objective was to keep the Group trading. To do this successfully, it needed to identify each of the stakeholders in the Group and establish a basis for dealing with each of those stakeholders to ensure their continued support of the trading operations of the Group. The stakeholders were:

Secured creditors

The first secured creditor was repaid in full approximately $11 million during January 1996. The second secured creditor was owed $75 million at the time of the appointment, approximately $45 million in principal and the balance in unpaid interest. It was also the major shareholder of the URA Group and two of the three directors of the Group were its nominees (the other director being a nominee of the first secured creditor). Neither liquidation nor receivership held any attraction for the secured lenders, and accordingly, their continued support of the administrators was assured.

Employees

With almost 2,000 employees across Australia, their continued support, amid obvious rumours of insolvency was paramount to the continued trading success of the Group. Reassurance of the employees by continuing to keep them informed of progress of the administration was essential. Poor morale is often reflected in poor sales and the administrators maintained a close dialogue with the employees throughout the administration. They also provided a written undertaking to each employee that all employee entitlements would be paid by the administrators.

Retention of title (ROT) creditors

In October 1995, a report was prepared for the secured lenders concerning, among other things, the Group's exposure to ROT claims. That report, which was subsequently provided to the administrators after their appointment, found that ROT was a fairly insignificant issue for the Group, with only 10 suppliers having ROT supply terms and approximately $4 million in stock being subject to ROT.

The Problem

After their appointment, the administrators carried out their own enquiries by circulating a request to all suppliers to notify the administrators of any ROT claims. The response to the administrators was breathtaking:

- Stock on hand at appointment: $44.8 million
- Amount owed to ROT claimants: $11.8 million
- Total stock attaching to ROT claims: $22.1 million
- Total ROT claimants: 75

The largest ROT claimant was owed $3.2 million.

Dealing with the ROT creditors quickly became a major threat to the success or failure of the administration. The mood of the ROT creditors was ugly.

- Most were at their highest level of exposure to the Group having met supply requests in the lead up to Christmas.
- In many instances, the management of the Group had negotiated extended credit terms to enable payment to take place early in the New Year after the Christmas trading period.
- Four million dollars in creditor cheques were released three days prior to appointment but $2 million of these were dishonoured as a consequence of the appointment of the administrators.
- This industry had not been exposed to a large insolvency appointment and these creditors were therefore inexperienced in dealing with the problems now posed by the insolvency of URA.

The Solution

- The administrators were able to avail themselves of the protection afforded by sections 440C and 442C of the Law.
- Section 440C provides that an owner cannot recover property used by the company during the administration without leave of the court or the administrator's consent. This provision

provided interim protection for stock held by the Group and allowed the administrators time to negotiate with suppliers.

- Section 442C allows the administrator to dispose of the owner's assets in the ordinary course of business. Shortly after their appointment, the administrators provided an undertaking to all ROT suppliers that to the extent that an individual ROT supplier's clause was found by the court to be valid and enforceable in respect of certain stock, the administrator would pay the supplier the invoice cost of that stock sold during the administration period. This undertaking pacified suppliers and allowed the administrators time to consider each of the ROT claims.
- The administrators then obtained relevant documentation from each of the ROT suppliers, and reviewed that documentation in the light of the company's own records.
- Senior counsel's opinion was obtained on several issues which impacted on the claims generally.
- An ROT formula was then developed to take account of the weaknesses of each ROT clause and to weight each claimant's prospects of success if the claim was litigated.
- The administrators then provided a letter of offer to each of the claimants based on the formula and the administrators' assessment of the chances of the supplier if it took its claim to court.
- Ultimately, and in many instances after further negotiations and discussions, agreement was reached with all ROT creditors and documented.
- The integrity of the settlement process was maintained, in that the administrators did not engage in "horse trading". Offers were only revised when it was demonstrated that the factual assumptions underpinning the weighting were inaccurate.
- The settlements were approved by the secured lender as a result of which ROT creditors received as their ROT component on average 61 cents and then a further unsecured component of 18 cents giving a total return of 79 cents in the dollar.

Observations

- Retention of title claims may have been a disaster in the context of a receivership of the URA Group. With the protection of the Corporations Law available in a voluntary administration, the administrators were able to achieve a result which avoided litigation, minimised the cost of resolution, provided an excellent return to ROT creditors and, most importantly, guaranteed the continuing support of the suppliers in the trading operations of the Group.
- The underlying lesson for secured creditors is, however, that ROT claims continue to have a significant impact on the value of security. The significance of stock to secured creditors in the context of total secured assets must be a matter of ongoing concern to all lenders.

Leased creditors

At the time of appointment, the Group operated 193 separate retail locations throughout Australia. The stores were for the most part in larger shopping centres with shops in Sydney, Melbourne, Brisbane and Perth enjoying prime CBD positions. Once again, the administrators were able to obtain the protection of section 440C and to occupy the retail locations without an immediate concern of being locked out.

The administrators immediately undertook a review of each of the existing leases with a view to identifying those leases where rental reductions or concessions could be negotiated, or where there may be a need for refurbishment.

Using that review, the administrators successfully negotiated with landlords and obtained concessions which included rental reductions on base rentals, rental abatements and a commitment to renegotiate the leases with the purchaser of the URA Group in due course. Some commitments were also obtained from landlords to contribute towards refurbishment costs. This "clean-up" of the shops occupied by the URA Group provided significant assistance to the administrators in preparing cash flow projections as the businesses were prepared for sale.

Customers

Obviously the insolvency of the URA Group was a matter for much speculation in the press, and certainly in the retailing industry. The continued support of customers was essential to the continued viability of the Group and in order to maximise its sale price. Furthermore, at appointment, approximately $5.5 million was held by the Group in lay-by deposits. Customer goodwill was essential and the administrators quickly adopted a "business as usual" approach. This included meeting all lay-bys and continuing with an active sales promotion schedule.

Indeed, one of the first issues confronted by the administrators was the hostility of the advertising agency which was owed approximately $150,000 at the time of the appointment. The agency claimed intellectual property rights over the advertising campaign for the Christmas-New Year period which had been booked with television stations and the print media, and refused to release its material until agreement was reached on payment of:

(a) its outstanding fees; and

(b) its future fees.

Although litigation was commenced, a settlement was quickly reached and the scheduled advertising proceeded albeit at a reduced level. This allowed the sales targets of the URA Group over the Christmas-New Year period to be maintained.

Ordinary unsecured creditors

From the outset, it was going to be difficult for the administrators to provide an accurate assessment of the likely outcome to unsecured creditors. One thing was for certain: if the Group went into liquidation, there would be nothing for unsecured creditors other than through the possibility of recovery through Part 5.7B proceedings. However, at the adjourned "proposal meeting" held on 4 March 1996, where creditors resolved to enter into deeds of company arrangement for each of the companies in the Group, the administrators were able to indicate that the final outcome for unsecured creditors would be on a sliding scale depending on the sale price the administrators were able to achieve in their negotiations which were continuing, but not at that time concluded.

Estimates of the return to unsecured creditors were based on a sliding scale of the sale price in the range from $45 million to $76 million. At the meeting, while the administrators were able to indicate that they anticipated a dividend of approximately 40 cents in the dollar for unsecured creditors, the creditors were reluctant to vote in favour of the company executing a deed of company arrangement when the administrators could give no firm assurance on the amount of the dividend.

As a result, a safety net was agreed by resolution at the meeting whereby the administrators were authorised to execute deeds of company arrangement subject to a minimum dividend to unsecured creditors of 30 cents in the dollar. If this was not achieved, then a further meeting of creditors was to be convened.

Ironically, negotiations for the sale of the business were concluded the following day, 5 March 1996 as a result of which the administrators were able to announce to the Committee of Creditors that offers they had received would provide a dividend of approximately 43 cents in the dollar to unsecured creditors.

Ultimately, unsecured creditors received a final dividend totalling 45 cents in the dollar, including an interim dividend of 40 cents in the dollar being paid on 31 July 1996, (ie just 7 months after the date of appointment of the administrators) and two further payments of 2.5 cents in the dollar since that time.

Shareholders

The shares in the URA Group were all held by the first and second secured lenders. Their investment in the URA Group was lost.

Maintaining, Improving and Selling the Business

During the administration, the administrators were able to deal with the concerns of each of the stakeholders as a result of the protection provided by Part 5.3A of the Law. While the position of the stakeholders at appointment was a mixture of anger, uncertainty and apprehension, it soon emerged that for the position of the stakeholders to be protected and in certain circumstances improved, it was critical that they each support, albeit under close monitoring, the progress of the administration and the steps taken by the administrators to sell the business.

To balance the interests of the stakeholders was crucial to the preservation of the business. The administrators also took steps to improve the business during the administration in a number of ways, notably by:

(1) commissioning and implementing a costs reconstruction report which improved profitability projections and thereby enhanced the sale price;

(2) renegotiating rents and generally tidying up arrangements with all landlords;

(3) concluding negotiations with the Australian Taxation Office (ATO) concerning sales tax. A claim from an ATO audit of approximately $7.5 million for additional taxes and penalties was ultimately settled for $447,000; and

(4) enhancing the accounting system, which although functional, was inadequate for a number of particular tasks. The administrators put in place additional reporting requirements which assisted in efficiencies, particularly cash management and control.

Selling the Business

An Information Memorandum was circulated to approximately 50 parties and final offers were called for on 29 February 1996.

The successful offers were accepted on 12 March 1996 and contracts exchanged on 22 April 1996. The deeds of company arrangement were executed at this time and a completion of the contracts was effected on 31 May 1996.

Between 12 March 1996 and 22 April 1996 the sale price which was achieved involved twelve contracts for five separate corporate entities involving the sale of businesses of seven operating subsidiaries.

The Outcome for Stakeholders

- The first secured creditor was paid out 100 cents in the dollar in January 1996.
- The second secured creditor received approximately $55 million, $45 million principal debt and approximately $10 million in accrued interest.
- 1900 out of 1943 jobs were preserved, with retrenchments confined to "head office".
- For lease creditors there were no stores closed out of 193 across the nation.
- There was no disruption to customer services and all lay-bys were honoured by the administrators.
- For unsecured creditors, ROT creditors were paid an average of 60 cents in the dollar for their pre-appointment ROT claims (and 100 cents in the dollar for the period of the administrators' trading). They also participated as unsecured creditors for the residual debt.
- Other unsecured creditors were paid 45 cents in the dollar for pre-administration trading debts, and 100 cents in the dollar for the period of the administrators' trading.
- The shareholders lost their investment in the URA Group.

The URA voluntary administration showed what could be achieved through the operation of Part 5.3A for the stakeholders of an insolvent company. Most voluntary administrations are not, however, of the size and complexity of the URA administration and sadly, the full participation of all stakeholders in seeking to achieve an outcome, consistent with the objects of Part 5.3A, is on many occasions absent.

THE BAD: ASC RESEARCH PAPER 98/01

In their study conducted in 1995, Coopers & Lybrand concluded that:

> "A voluntary administration which:
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> 1. results in formal liquidation;
> 2. provides for liquidation of assets through a deed; or
> 3. provides for a debt written off by creditors which is commensurate with the estimated loss of liquidation
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> cannot be said to be meeting the legislation's objectives. The majority of voluntary administrations to date have resulted in one of the above outcomes, rather than a preservation of the business as a going concern or an improved recovery for creditors."

The ASC has recently published Research Paper 98/01 – A Study of Voluntary Administrations in New South Wales. More than two years since the Coopers & Lybrand report, the findings of the ASC report tend to support the view that many voluntary administrations are not meeting the legislation's objectives, and implicit in the ASC's report is the fact that this position is likely to continue, or even deteriorate further.

The background of the ASC report may be traced back several years, to when the ASC became increasingly aware of anecdotal evidence of the "misuse" of the voluntary administration process.

At a meeting of the Insolvency Practitioners Association of Australia held on 28 March 1996, the National Co-Ordinator Enforcement of the ASC, Andrew Proctor, advised that:

"(a) reports that the voluntary administration process is being abused had become too persistent to be ignored;

(b) there were persistent allegations about the conduct of administrators in the areas of:

- pre-arranged sales of assets, particularly to associates for inadequate consideration;
- failure to properly enquire into possible preference payments;
- failure to promptly inform creditors when it is clear that no practical arrangement is possible and liquidation is the only option;
- failure to inquire into apparent breaches by company officers and into the circumstances of directors' loans; and
- arrangements in which a small amount of money is kept back to allow an administrator to offer creditors a few cents in the dollar to 'keep them happy'.

(c) there was almost total non-compliance with section 438D which requires administrators to lodge a report with the ASC where they are of the opinion that officers or others may have been guilty of an offence, negligence, default, breach of duty or trust in relation to the company. Practitioners were often of the view that certain offences may have occurred but failed to make the required report."

The ASC report was prepared applying particular data and criteria to an examination of:

A. The firms and practitioners who had undertaken the majority of Part 5.3A work by volume in New South Wales;

B. 31 administrations were selected from two firms (five practitioners);

C. A further 24 administrations involving 11 practitioners were reviewed with the aim of having a more representative sample.

The findings of the ASC report were divided into three categories:

(a) Compliance with the Law;

(b) Compliance with the Terms of the deed of company arrangement; and

(c) Other Issues.

I will refer to only a few of the findings in each of these categories which demonstrate issues which must be of major concern to regulators, and which highlight the fact that in many instances, the objects of Part 5.3A are not being met.

Compliance with the Law

(1) Finding: Most administrators were not making the required report to the ASC where they were of the opinion that a offences may have been committed by the company's officers.

Relevantly, section 438D requires that:

> "... if it appears to the administrator of a company under administration that ... a past or present officer ... of the company may have been guilty of an offence in relation to the company ... or may have been guilty of negligence, default, a breach of duty or breach of trust in relation to the company ... the administrator **must**:
>
> ...
>
> (c) lodge a report about the matter as soon as practicable; and
>
> (d) give the Commission such information, and such access to and facilities for inspecting and taking copies of documents, as the Commission requires."

Given the number of companies which move from administration into liquidation, or where the deed of company arrangement does not succeed and the company ultimately is liquidated, it would appear that this section of the Law is, to be charitable, not working very well. There surely must be more than the odd occasion when the insolvency of a company has something to do with the conduct of its officers worthy of a report pursuant to section 438G. It is also more than likely that the most valuable asset of a company is the right of action of a liquidator against directors or other officers of the company as a result of their breach of their statutory or fiduciary duties.

It might be argued that section 438D(3) provides the court with the power to direct an administrator to lodge a report, upon the application "of an interested person or of its own motion", if it appears to the court that an "... officer ... of a company under administration has been guilty of an offence ..." etc. Sadly, it is unlikely that an unsecured creditor or other "interested person" would have sufficient facts available to sustain such an application. The onus must remain with the administrator to comply with his or her obligations under the Law, and to lodge a report where it is warranted.

(2) Finding: Most administrators were not insisting on receiving a signed report as to affairs (RATA) from the directors (section 438B(2)).

Section 438B(2) provides that:

> "Within 7 days after the administration of a company begins or such longer period as the administrator allows, the directors must give to the administrator a statement about the company's business, property, affairs and financial circumstances."

One could forgiven for suggesting that without the administrator obtaining a RATA as required by the Law within 7 days of his appointment, it is likely that he will have little or no understanding of trading and financial standing of the company, or at least the directors' view of those matters at the time of appointment. Indeed, it is difficult to see how an administration could properly proceed, and the administrator discharge his duty to all relevant stakeholders, until such time as he did have presented to him a signed RATA from the directors.

It is perhaps no accident that without obtaining signed RATAs, there are few reports lodged by administrators under section 438D. While the integrity of a RATA might need to be verified by the administrator, it at least provides a signed admission by the directors of their understanding of the position of the company at the time of appointment. What then flows from that is a matter for the administrator, and his compliance with his duties under Part 5.3A.

Compliance with the Terms of the Deed of Company Arrangement

(1) Finding: Practitioners were not complying with the terms of the deed of company arrangement in critical areas such as:

(a) receipt of monies payable under the deed on a timely basis;

(b) monitoring the deed and reporting to creditors; and

(c) taking timely action following default by the company.

(2) Finding: In more than 50% of cases reviewed where deeds of company arrangement were in operation, compliance with the timing for the receipt of deed monies was not enforced.

(3) Finding: When questioned, practitioners attempted to justify their failure to take action to enforce the terms of the deed of company arrangement by claiming that their action, or inaction, was in the best interests of creditors, or they were waiting on an amended proposal from directors to put to creditors. These reasons were not found to be agreed by creditors as being in their best interests.

Other Issues

(1) Finding: A clear conflict of interest issue was identified in the use by the administrator of the casting vote in cases where a meeting of creditors considered the question of the removal of the administrator, approval of deed of company arrangement and approval of remuneration.

It is a sad reflection that the ASC report concluded that "It is virtually impossible in most cases for external third party creditors to influence the voting on the above matters."

(2) Finding: Many deeds of company arrangement based on creditors being paid from further trading profits were recommended without an appropriate assessment of the viability of the business. The recommendation was based solely on the likelihood that there would be no return from a liquidation.

The ASC report found that this approach was "an abrogation of the administrators' professional duty, skill and care to make a defensible recommendation to creditors. Also, by allowing a business to continue, which on a proper assessment should cease trading creditors may sustain a greater loss by providing further credit to the company. The delay in liquidation often serves the interests of the directors and may make recovery actions by the liquidator more difficult."

(3) Finding: An increase in the overall costs of liquidation initiated through Part 5.3A. The ASC report identified a major disadvantage of the use of the voluntary administration process as a route to automatic liquidation is the potential for an increase in overall costs: "... if the only realistic outcome is liquidation, the creditors do not need to know much of the information required to be gathered and prepared for them during a voluntary administration. There is a cost associated with providing it and in holding a meeting to consider it."

It is difficult to determine the "success rate" for companies placed into administration in aspiring to the stated object of Part 5.3A in maximising the chances of the company, or its business, continuing in existence, or at least providing a better return for the companies' creditors and members. The ASC report records that in the period between 1 July 1993 and 30 June 1997,

approximately 890 companies were placed into voluntary administration in New South Wales of which:

- 38% entered into a deed of company arrangement;
- 59% proceeded to creditors voluntary liquidation;
- of those that entered into a deed of company arrangement, 17% then proceeded to liquidation.

These figures do not, however, indicate how the remaining 21% of companies that remained under a deed of company arrangement fared.

Presumably, many of those deeds of company arrangement which required payments to creditors out of future trading are yet to be completed. The findings of the ASC report, however, confirm that the voluntary administration process will not save a failed business and that sadly, this fact is not being identified in many cases and for reasons clearly identified in the report.

THE UGLY

While the voluntary administration process can provide a very effective means of maintaining the value of a trading operation of a company, the ASC report provides evidence which confirms the anecdotal concerns expressed by many, and which led to the report being prepared.

Conflicts of Interest

It seems from the report, and from my own experience, that the voluntary administration process is in many instances working substantially for the benefit of directors and administrators. I make the following observations:

(1) Without a signed RATA, it is much more difficult for an administrator make any effective assessment and recommendation to creditors concerning the possible breach of statutory or fiduciary duties by officers of the company.

(2) Voluntary administrators are generally appointed by the very directors whose conduct they are to investigate. Often they are appointed on the recommendation of the directors' accountant, who may have consulted with industry colleagues.

(3) Why is it that the bulk of the "voluntary administration market" is held by a relatively small number of practitioners in New South Wales? Is it because those practitioners are known to be rigorous in their investigation of the discharge of duties by directors? Do those practitioners have the highest rate of lodgment of reports to the ASC concerning the conduct of officers of the company? Are those practitioners renowned for obtaining the best possible result for unsecured creditors whether by way of liquidation or deed of company arrangement? It is unlikely that the directors would appoint a voluntary administrator with the above qualifications.

(4) If no RATA is produced by the directors, then the administrator's staff will be tied up for days, possibly weeks, in constructing a meaningful financial statement of the company. This will involve the incurring of further fees by the company with the administrator which are paid in priority to all other stakeholders, other than the interest of the secured creditor in the fixed charged assets.

(5) Then there is the conflict faced by the administrator in exercising his casting vote where there is a poll taken, and a deadlock between number and value of creditors on such issues as:

    - the administrator being replaced by another practitioner;

- the administrator's remuneration;
- whether the company is placed into liquidation or proceeds to execute a deed of company arrangement. (This is a particularly tricky issue where the company would have no assets available to pay for the costs of a liquidation, let alone a dividend to unsecured creditors, but where a deed of company arrangement promises a return from future trading profits.)

The Directors

My own experience has for the most part been in acting for the secured creditor of a company. Fortunately, in most circumstances, my client has been adequately secured and has not needed to actively participate in debating the benefits or otherwise of the company entering into a deed of company arrangement nor its subsequent implementation.

I have, however, observed the enthusiastic co-operation of the directors in ensuring that the secured creditor is paid out from the assets of the company or a refinance as soon as possible. Often, in a trading company, that may require the company selling its business premises to retire the secured creditors' debt and for the company to then continue to trade from leased premises, to enable the company to meet its obligations for future payments to creditors under a deed of company arrangement.

It is perhaps not surprising the speed with which a secured creditor is quarantined, given that in most circumstances, the secured creditor is holding as security for its debt the personal guarantee and personal assets of the directors. In many cases, the assets held as security by the secured creditor, both of the company and of the directors, would adequately pay both secured and unsecured creditors 100 cents in the dollar. If the secured creditors' debt is speedily paid from the proceeds of sale of the company's assets, the unsecured creditors may be lucky to receive a token dividend from the company while the directors receive a discharge of security over their personal assets from the secured creditor.

Subject, of course, to any rights of subrogation which may arise, the opportunity must exist for the administrators to exert more pressure on directors to contribute towards a deed of company arrangement where personal assets are freed up as a result of the repayment to the secured lender. The rigorous pursuit by administrators of insolvent trading issues against directors would enable the value of such claims to be more seriously viewed by directors. Where a secured creditor is being repaid, the administrator is then in an ideal position to know what third party security is also being released and should become available for a deed of company arrangement if the directors propose that the company should continue to trade.

Otherwise, especially where creditors are to be paid a dividend from future trading, the unsecured creditors (often mostly suppliers) are being asked, in effect, to fund this future trading, and to take a further risk with the company. There is no reason why, in many cases, the directors should not, in circumstances where their personal assets allow, assume more of this financial risk themselves.

A Remedy

Many difficulties of the process to which I have referred arise from a perception that administrators are working for or at the direction of directors, to the detriment of unsecured creditors. The ASC and the legislature must take firm action to rectify that perception. To start the debate, I make the following two suggestions which relate solely to the appointment of voluntary administrators:

1. If directors of a company believe it is appropriate for the company to be placed into voluntary administration, that they be required to apply to the court for an order to that effect and in support of that application, that the directors lodge an affidavit containing:

(a) a brief statement justifying why, if the company is insolvent and, having regard to the Law, they believe the company should proceed to voluntary administration and not liquidation; and

(b) attaching a signed report as to affairs.

2. If the court is satisfied that voluntary administration is appropriate, that the court then nominate who the administrator will be from its list of accredited specialists. In other words, as with the appointment of liquidators, administrators should have had no prior role in advising the company or its directors, and should be suitably qualified practitioners.

I would not accept an argument that this process would detract from the simplicity, delay and costs argument raised in support of the Law as it stands. An application to the court of the type I propose could be prepared by the directors of a company in consultation with their solicitor and accountant; would be made to the court ex parte and could be dealt with as an urgent matter.

The obvious benefits of these amendments to the Law would be to:

(a) ensure complete impartiality in the appointment of the voluntary administrator; and

(b) require the directors to

(i) justify in simple terms voluntary administration over liquidation for the company; and

(ii) disclose, from their own knowledge, the standing of the company at the time of appointment in a document which could be used and relied upon by the administrator in fulfilling his obligations as administrator under the Law.

While I agree with the ASC research paper that "the voluntary administration process is worthwhile", I believe the most challenging and important response to that research is not in the proposed practitioner education programme, nor in the guidelines for practitioners to be published, but in the area of law reform. The requirement for court approval for the voluntary administration process and for the appointment of an independent administrator would go a long way towards correcting the unfortunate perceptions of the voluntary administration process which have inevitably arisen.